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Nos. 89-1452 and 89-1453

In the Supreme Court of the United States

OCTOBER TERM, 1990

MOBIL OIL EXPLORATION & PRODUCING SOUTHEAST, INC., ET AL., PETITIONERS

v.

UNITED DISTRIBUTION COMPANIES, ET AL.

FEDERAL ENERGY REGULATORY COMMISSION, PETITIONER

v.

UNITED DISTRIBUTION COMPANIES, ET AL.

ON WRITS OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR THE FEDERAL ENERGY REGULATORY COMMISSION

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QUESTIONS PRESENTED

1. Whether the Federal Energy Regulatory Commission lawfully exercised its authority to raise the price ceiling for "old" natural gas in conformity with the requirement in Sections 104(b)(2) and 106(c) of the Natural Gas Policy Act of 1978, 15 U.S.C. 3314(b)(2) and 3316(c), that the "higher" price be "just and reasonable within the meaning of the Natural Gas Act."

2. Whether Section 7(b) of the Natural Gas Act, 15 U.S.C. 717f(b), permits the Commission to prescribe in advance and on a generic basis the conditions under which the abandonment of services will be authorized, rather than requiring case-by-case adjudication.

3. Whether the court of appeals erred in holding that the Commission could not adopt the orders at issue here (which increase the price ceiling for old gas but establish a good faith negotiation procedure to protect pipeline-purchasers against automatic imposition of the increase) unless it first solved the problems created by "take-or-pay" clauses in certain pipelines' natural gas contracts, even though the Commission has addressed the "take-or-pay" problem in separate administrative proceedings.

PARTIES TO THE PROCEEDING

The parties to the proceeding in No. 89-1452 are listed in the appendix to the petition in that case at 76a-82a. The petitioner in No. 89-1453 is the Federal Energy Regulatory Commission. The respondents in that case are listed in the appendix to the petition at 83a-86a.

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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-60a)[1] is reported at 885 F.2d 209. The orders of the Federal Energy Regulatory Commission (J.A. 5-205 (Order No. 451), 206-435 (Order No. 451-A), and 437-467 (Order No. 451-B)) are reported at 51 Fed. Reg. 22,168; 51 Fed. Reg. 46,762; and 52 Fed. Reg. 21,669, respectively.

[1] "Pet. App." refers to the appendix to the petition for a writ of certiorari in No. 89-1453.

JURISDICTION

The judgment of the court of appeals was entered on September 15, 1989, and petitions for rehearing were denied on December 15, 1989. Pet. App. 61a-62a. The petitions for a writ of certiorari were filed on March 15, 1990, and were granted on June 4, 1990. The jurisdiction of this Court rests upon 28 U.S.C. 1254(1).

STATUTORY AND REGULATORY PROVISIONS INVOLVED

Sections 4(a), 5(a) and 7(b) of the Natural Gas Act of 1938, 15 U.S.C. 717c(a), 717d(a) and 717f(b); Sections 104 and 106 of the Natural Gas Policy Act of 1978, 15 U.S.C. 3314 and 3316; and 18 C.F.R. 157.301, 270.201, 271.402 and 271.602 (the regulations affected by the Orders of the Federal Energy Regulatory Commission) are reproduced in relevant part in an appendix to this brief. App., *infra*, 1a-18a.

STATEMENT

This case involves the validity of Order No. 451 of the Federal Energy Regulatory Commission, which was issued in 1986 to address the serious dislocations in the natural gas market that resulted from the outdated pricing structure for "old" gas (gas that was already in production on the date of enactment of the Natural Gas Policy Act of 1978 (NGPA), 15 U.S.C. 3301 *et seq.*). Prior to Order No. 451, old gas was divided into a number of categories ("vintages"), for which the price ceiling varied according to such factors as the year production commenced, the size of the producer, whether the gas was sold under a renewal contract, and the region in which the gas was produced. Order No. 451 collapsed those diverse vintages into a single category subject to a single price ceiling. The Commission based its modification of the old gas pricing structure on Sections 104(b)(2) and 106(c) of the NGPA, which permit the Commission, "by rule or order," to raise the ceiling price for "any" old gas to a "higher" price, as long as it is "just and reasonable within the meaning of the Natural Gas Act." 15 U.S.C. 3314(b)(2), 3316(c). A divided court of appeals in this case held that Order No. 451 was beyond the Commission's authority under the NGPA, even though the court did not disturb the Commission's judgment that the single price ceiling for old gas was "just and reasonable" within the meaning of the Natural Gas Act.

A. Historical Background: The Course of Wellhead Price Regulation

1. Prior to enactment of the Natural Gas Policy Act of 1978, the sale and transportation of natural gas in interstate commerce were regulated by the Commission (and its predecessor, the Federal Power Commission) exclusively under the Natural Gas Act of 1938. Section 4(a) of the NGA imposes on the Commission an obligation to ensure that all rates and charges requested by a regulated natural gas company in connection with the transportation or sale of natural gas within the Commission's jurisdiction are "just and reasonable." 15 U.S.C. 717c(a). Section 5(a) of the NGA similarly provides that when the Commission determines that any "rate, charge, or classification" observed by a natural gas company in connection with the transportation or sale of gas (or any "rule, regulation, practice, or contract" affecting such rate, charge, or classification) is "unjust" or "unreasonable," the Commission "shall determine the just and reasonable rate, charge, classification, rule, regulation, practice, or contract to be thereafter observed and in force, and shall fix the same by order." 15 U.S.C. 717d(a).

As this Court explained in *Public Serv. Comm'n* v. *Mid-Louisiana Gas Co.*, 463 U.S. 319, 327-331 (1983), the Commission, with the approval of the courts, has followed a number of different approaches over the years in giving content to the broad "just and reasonable" standard under the NGA. Initially, when the Commission confined its rate regulation to interstate pipelines, it proceeded on a company-by-company basis, studying the historical costs incurred by each pipeline company in ac-

quiring natural gas for, and transporting gas to, its customers. The Court sustained that approach in *FPC* v. *Hope Natural Gas Co.*, 320 U.S. 591 (1944), explaining that Sections 4 and 5 of the NGA do not bind the Commission "to the use of any single formula or combination of formulae in determining rates," and that "[u]nder the statutory standard of 'just and reasonable,' it is the result reached not the method employed which is controlling." 320 U.S. at 602. The Court thus dispelled the notion, emanating from *Smyth* v. *Ames*, 169 U.S. 466 (1898), that the only constitutionally permissible rate structure is one based on the *current* fair value of the utility's assets. See *Duquesne Light Co.* v. *Barasch*, 109 S. Ct. 609, 616-620 (1989).

2. The Commission began to depart from its company-by-company, historical-cost approach after *Phillips Petroleum Co.* v. *Wisconsin*, 347 U.S. 672 (1954), which held that the NGA requires the Commission to regulate not only the downstream rates charged by interstate pipelines, but also the upstream sales rates charged at the wellhead by thousands of independent gas producers. In response to *Phillips*, and presented with an overwhelming number of producer rate cases to process, the Commission turned to an "area rate" approach for independent producers, while retaining the individualized "cost-of-service" method of regulation for interstate pipelines.

The area rate approach, as first articulated in 1960 in the Commission's *Statement of General Policy*, No. 61-1, 24 F.P.C. 818, provided for the establishment of a single rate schedule for all gas produced in a given region, based on the region's average production costs, investment, and rates of return. Each area rate schedule contained two separate price ceilings: a lower ceiling for gas prices established in "old" contracts and a higher ceiling for gas prices established in "new" contracts. *Id.* at 819. The Commission rested its two-tiered "vintage pricing" system on the premise that although higher ceiling prices for new gas would encourage additional gas production, "price could not serve as an incentive" for the production of old gas and "any price above average his-

torical costs, plus an appropriate return, would merely confer windfalls." *Permian Basin Area Rate Cases*, 390 U.S. 747, 797 (1968). However, the Commission anticipated that "these differences in price levels will be reduced and eventually eliminated as subsequent experience brings about revisions in the prices in the various areas." 24 F.P.C. at 819.

In *Permian Basin*, the Court sustained the Commission's two-tiered area rate approach. 390 U.S. at 795-799. It held that the courts are without authority to set aside any rate selected by the Commission that is within a "zone of reasonableness," *id.* at 767, and that within this zone, the Commission may "employ price functionally in order to achieve relevant regulatory purposes" and "may, in particular, take fully into account the probable consequences of a given price level for future programs of exploration and production." *Id.* at 797. Accord *Mobil Oil Corp.* v. *FPC*, 417 U.S. 283, 320 (1974).

3. By the time of the rapid rise in natural gas prices during the early 1970s, it had become clear that the two-tiered area rate approach, based on average historical costs, "was not working" and "had led to serious production shortages." *Mid-Louisiana Gas*, 463 U.S. at 330. In response, the Commission shifted to a regime of uniform "national rates" for most gas drilled after December 31, 1972. In Order No. 699 (*National Rates for Natural Gas*, 51 F.P.C. 2212 (1974)), the Commission established a national rate ceiling for gas drilled during the two-year period beginning January 1, 1973, and announced its intention to establish separate price ceilings for gas drilled during each succeeding two-year period. Soon thereafter, in a further refinement of its national rate policy, the Commission "shift[ed] from a pure historical-cost-based to an incentive-price-based approach" and "temporarily abandon[ed] the practice of vintaging." *Mid-Louisiana Gas*, 463 U.S. at 330 (citing *National Rates for Natural Gas*, 52 F.P.C. 1604, 1615-1618, 1636 (1974) (Order No. 699-H)). Specifically, in Order No. 699-H, the Commission: (1) prescribed a national rate designed to "encourag[e] increased future drilling efforts and the

discovery of incremental gas supplies to avert ever deepening natural gas shortages," 52 F.P.C. at 1615, and (2) announced that the Commission would not prescribe different rates for succeeding biennial vintages (as it had recently stated in Order No. 699), but would instead establish a *single* maximum rate for *all* post-1972 gas and periodically revise that single rate. *Id.* at 1636-1638. The Fifth Circuit sustained this shift, noting that the vintage rate structures had been "experimental" from the outset. *Shell Oil Co.* v. *FPC*, 520 F.2d 1061, 1073-1074, 1077-1078 (1975), cert. denied, 426 U.S. 941 (1976); see also *Shell Oil Co.* v. *FPC*, 491 F.2d 82, 87-89 (1974).[2]

The Commission's non-vintage pricing regime for post-1972 gas proved to be short-lived. In Order No. 770 (*National Rates for Natural Gas*, 56 F.P.C. 509 (1976)), the Commission established a new (and substantially higher) national rate ceiling for gas first sold in the 1975-1976 biennium, but it allowed only a smaller increase in the ceiling prescribed by Order Nos. 699 and 699-H for 1973-1974 biennium gas. This reinstitution of vintage pricing for post-1972 gas was sustained by the D.C. Circuit in *American Public Gas Ass'n* v. *FPC*, 567 F.2d 1016 (1977), cert. denied, 435 U.S. 907 (1978), which, like the Fifth Circuit in *Shell Oil*, stressed the

[2] The Commission authorized "small producers" (those selling less than 10 billion cubic feet of gas per year) to sell gas at market-based prices, even if they were above otherwise applicable area or national rates. *Exemption of Small Producers from Regulation*, Order No. 428, 45 F.P.C. 454 (1971). In this manner, the Commission proposed to remove all direct regulation of small producer rates and instead subject those rates only to "indirect regulation"—*i.e.*, to Commission review of the purchased-gas costs of the pipelines and large producers that purchased from small producers. In *FPC* v. *Texaco, Inc.*, 417 U.S. 380 (1974), the Court held that the NGA permits the Commission to undertake such "indirect regulation" and to take market prices into consideration (albeit not to the exclusion of all other factors) when setting producer rates. *Id.* at 387-391, 397-399. However, the Court remanded the case to the Commission because it had failed to articulate a sufficient basis for its order. *Id.* at 395-397.

experimental nature of the Commission's treatment of vintaging. 567 F.2d at 1033-1034. The D.C. Circuit also sustained the Commission's decision in Order No. 770 to increase the price ceiling for gas covered by renewal contracts, finding it appropriate to place a portion of the burden of developing new sources of supply on the consumers whose access to this cheaper gas was "largely an historical accident." *Id.* at 1058.

At about the same time, the Commission consolidated a number of the pre-1973 rates for each separate producing area into a single nationwide category comprised of gas flowing prior to January 1, 1973. Order No. 749 (*National Rates for Natural Gas*, 54 F.P.C. 3090 (1975)). The Fifth Circuit sustained the considerably higher price ceiling that resulted for the oldest of this pre-1973 gas, finding it to be justified by administrative convenience and the need to factor in an allowance for the "replacement cost" of exploring for and developing new sources of supply. *Tenneco Oil Co.* v. *FERC*, 571 F.2d 834, 841-842, cert. denied, 439 U.S. 801 (1978).

Despite this consolidation of the pre-1973 area rates, the Commission's regulations in effect in the mid-1970s continued to provide for a number of separate "vintage" categories of gas, each subject to its own price ceiling. The broadest categories were pre-1973 ("flowing") gas, 1973-1974 biennium gas, and post-1974 gas.[3] But there were three additional categories of pre-1973 gas as well, covering three of the producer areas (Permian Basin, Rocky Mountain, and Appalachian Basin) for which price ceilings higher than the new national ceiling had already been established in separate proceedings. See *Tenneco Oil Co.*, 571 F.2d at 837. The Commission also had created a separate category for gas covered by renewal contracts, discussed above. And to complicate

[3] On March 1, 1977, the Commission initiated proceedings to establish yet another price ceiling for gas from wells commenced on or after January 1, 1977. *Order Instituting National Rate Proceeding*, 57 F.P.C. 1238. However, the Commission took no action on this biennial update after the NGPA bills were introduced in Congress.

matters still further, each of the foregoing categories (except post-1974 gas) was subdivided into two subcategories, one for large producers and one for small producers. As of December 1978, the price ceilings for these 15 categories and subcategories ranged from a high of $1.630 per million BTU's (for all post-1974 gas) to a low of $0.332 per million BTU's (for large-producer pre-1973 gas). See 18 C.F.R. 271.101 (Table II), at 367 (1990).

This, then, was the collection of price ceilings in effect when Congress enacted the Natural Gas Policy Act of 1978.

B. The Pricing Scheme Enacted In The NGPA

The national rate approach, coupled with the Commission's supervision of the complex set of vintage price ceilings, proved inadequate to solve the problems besetting the production and distribution of natural gas. The rate structure caused ceiling prices for interstate gas sales to fall considerably below prices the same gas could command in the intrastate market, which was not federally regulated. The resulting price dichotomy soon resulted in severe gas shortages in the interstate market. Congress responded to this situation by enacting the Natural Gas Policy Act. See *Transcontinental Gas Pipe Line Corp.* v. *State Oil & Gas Bd.*, 474 U.S. 409, 420-421 (1986) (*Transco*); *Mid-Louisiana Gas*, 463 U.S. at 330-331.

The NGPA instituted a "national market price regulatory scheme," covering intrastate as well as interstate sales, the purpose of which is "to assure adequate supplies of natural gas at fair prices." *Transco*, 474 U.S. at 421. The price ceilings established by the NGPA depended primarily upon the date the gas was first produced and the relative difficulty of producing it. Thus, the NGPA established higher ceiling prices for new or hard-to-produce gas and, at the same time, prescribed a scheme of phased deregulation for most such gas. §§ 102, 103, 105, 107, and 108 (15 U.S.C. 3312, 3313, 3315, 3317, 3318). Under that scheme, "the price ceilings for certain 'high-cost' gas were eliminated in 1979, for certain 'old' intrastate gas and 'new' gas in 1985, and for certain other 'new' gas in 1987." *FERC* v. *Martin Exploration Management Co.*, 486 U.S. 204, 207 (1988); see § 121, 15 U.S.C. 3331.

The NGPA adopted a different approach for "old" gas and for certain types of interstate gas subject to "rollover contracts." [4] Sections 104 and 106, 15 U.S.C. 3314 and 3316, furnished initial NGPA price ceilings for this gas by carrying forward the ceilings that previously had been prescribed by the Commission under the NGA, but mandated that those ceilings be automatically adjusted by a monthly inflation factor. 15 U.S.C. 3314(b)(1), 3316(a). The effect was to carry forward (albeit adjusted for inflation) the same 15 vintage price ceilings that happened to be in effect for old gas when the NGPA was enacted. Congress also recognized, however, that the price ceiling for old gas "may be too *low* and authorize[d] the Commission to raise it whenever traditional NGA principles would dictate a higher price." *Mid-Louisiana Gas*, 463 U.S. at 333 (citing NGPA Sections 104 and 106). Specifically, Sections 104(b)(2) and 106(c) both authorize the Commission, "by rule or order," to prescribe a "higher" ceiling price for old gas, "if such price is * * * just and reasonable within the meaning of the Natural Gas Act." 15 U.S.C. 3314(b)(2), 3316(c).

The Court described the overall thrust of this comprehensive new regulatory scheme in *Mid-Louisiana*, 463 U.S. at 333:

> In each category of gas, the statute explicitly establishes an incentive pricing scheme that is wholly divorced from the traditional historical-cost methods applied by the Commission in implementing the NGA. The price is established either in terms of a dollar figure per million Btu's, or in terms of a previously

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[4] Section 2(12) of the NGPA defines a "rollover contract" as a contract entered into on or after November 8, 1978, for the first sale of natural gas that was previously subject to a contract that expired at the end of a fixed term specified in the contract itself. 15 U.S.C. 3301(12).

existing price, and is inflated over time according to a statutory formula.

C. Promulgation of Order No. 451

The NGPA went far to remedy the disparity that had developed between the interstate and intrastate natural gas markets under the NGA, and the higher prices permitted by the NGPA led to increased gas production, which alleviated shortages. Nevertheless, as the court below recognized, the "natural gas market became fraught with distortions." Pet. App. 9a. For example, although the greater production fostered by the NGPA, coupled with decreased demand, led to excess supply, prices paid by consumers continued to increase. Furthermore, the lower ceiling prices for old gas that were carried forward for the time being under the NGPA led to inadequate development and premature abandonment of extensive reserves of old gas, even though the marginal cost of producing old gas often was less than the marginal cost of producing other types of gas. The resulting shift to production of new and high-cost gas, rather than development of extensive old gas reserves, produced higher prices for consumers and created incentives to import foreign oil and gas. 51 Fed. Reg. 22,174-22,175 (1986) (J.A. 32-36).

Against this background, the Secretary of Energy, pursuant to Section 403 of the Department of Energy Organization Act, 42 U.S.C. 7173, formally recommended that the Commission issue a notice of proposed rulemaking to revise the pricing system for old gas. 50 Fed. Reg. 48,540 (1985). The Commission initiated those proceedings in November 1985. After reviewing extensive comments filed by all segments of the natural gas industry and after holding a two-day public conference, the Commission issued Order No. 451, at issue here, in June 1986. 51 Fed. Reg. 22,168 (J.A. 5-205). In December 1986, the Commission issued Order No. 451-A, which reaffirmed the basic approach of Order No. 451, while modifying certain of its details. 51 Fed. Reg. 46,762 (J.A. 206-436).

1. Based on the voluminous record of the rulemaking proceedings, the Commission concluded that the maximum lawful prices for old gas should be raised, because the vintage prices "fail[ed] to assign a reasonable share of the replacement cost or marginal cost of new supplies to purchasers of old gas." 51 Fed. Reg. at 22,170 (J.A. 15). The Commission made several critical findings on this point. First, it agreed with the Secretary of Energy and other commenters that valuable supplies of inexpensive old gas that remained subject to the price ceilings carried forward under Sections 104(b)(1) and 106(a) of the NGPA were being inadequately developed or prematurely abandoned. In the Commission's judgment, an increase in old gas prices would encourage recovery of an additional 11 trillion cubic feet of natural gas that otherwise would be permanently lost. 51 Fed. Reg. at 22,170, 22,172, 22,180, 46,774-46,779 (J.A. 15, 24, 54, 259-275). Second, the Commission determined that the various vintage ceilings, as then preserved, kept old gas priced well below the competitive market price for wellhead sales of higher-priced new gas, thereby creating an artificial and unfair competitive advantage for those pipelines that had access to large supplies of old gas and for the regions and customers served by those pipelines. "This means consumers, purely by the accident of vintaging, pay different gas prices for reasons wholly unrelated to the value of the commodity or the cost of replacing it." *Id.* at 22,172, 46,766 (J.A. 25, 227).[8] Third, the Commission found that the low prices for old gas further distorted the market by permitting producers that had a cushion of old gas to "roll in" the prices of new and deregulated gas with artificially low prices for old gas, thereby enabling them to charge a higher price for incremental supplies of new and deregulated gas than pur-

[8] The Commission noted that as a result of differing access to old gas, the average residential price of gas in Maine and Connecticut in 1984 was $9.58 and $8.80 per thousand cubic feet (Mcf), respectively, while in Arkansas and Kansas it was only $4.37 and $4.49 per Mcf. 51 Fed. Reg. at 22,176 (J.A. 39).

chasers otherwise would be willing to pay. *Id.* at 22,172 (J.A. 25); see generally *id.* at 46,765-46,768 (J.A. 223-233).

For the foregoing reasons, the Commission found that the then-existing vintage price structure for old gas was "the major cause of the market distortions identified by the Commission," and it accordingly determined that the price ceilings for old gas were unjust and unreasonable within the meaning of the NGA. 51 Fed. Reg. at 22,182, 46,765-46,766 (J.A. 62, 223-224). The Commission further concluded that "the current problems being experienced in natural gas markets would largely be remedied by collapsing vintages and raising ceiling prices of below-market priced gas." *Id.* at 22,182 (J.A. 63); see also *id.* at 46,766-46,767 (J.A. 224-231). The Commission therefore decided to consolidate the 15 separate vintage categories of old gas into one category and to establish an alternative maximum price that a producer may charge for gas in that category—but only to a willing purchaser. See pages 13-15, *infra*.

Specifically, this single new category was made subject to a price ceiling equal to the highest of the ceilings then in effect for old gas (that having a post-1974 vintage), adjusted monthly for inflation. 51 Fed. Reg. at 22,183-22,185 (J.A. 69-77); see 18 C.F.R. 271.402(c)(3)(iii) and (7), 271.602(a)(3). The Commission explained that the ceiling price for old gas should approximate, as closely as possible, the replacement cost of that gas, in order to assure an adequate long-term supply. Because the Commission and the D.C. Circuit had found the ceiling price for post-1974 gas to be just and reasonable inasmuch as it was based on the then-current costs of finding and producing gas—and because the ceiling price for post-1974 vintage gas had been adjusted for inflation since 1977—the Commission concluded that the ceiling as so adjusted (which stood at $2.57 per million BTUs) approximated replacement cost in 1986 and therefore was "just and reasonable" within the meaning of the NGA. 51 Fed. Reg. at 22,183-22,190, 22,194, 46,768, 46,771-46,774 (J.A. 69-95, 109-112, 233-235, 245-257).

The Commission recognized that this alternative ceiling price exceeded the then-current market price for old gas, but it noted that the ceiling "is no higher than the highest vintage rate Congress itself retained for flowing gas under the NGPA"—*i.e.*, the rate carried forward by Section 104(b)(1) for post-1974 old gas. 51 Fed. Reg. at 22,177 (J.A. 43). Moreover, the Commission projected that in the long term, market forces would result in lower (and more stable) prices overall, as trillions of additional cubic feet of the relatively low-cost old gas increasingly competed with higher-priced categories of gas. 51 Fed. Reg. at 22,190-22,204, 46,779-46,784 (J.A. 95-141, 276-295). The Commission found this projection to be supported by: (1) Congress's judgment when it enacted the NGPA that the wellhead market for natural gas had become competitive, (2) the declining price of gas that had been decontrolled under the NGPA, and (3) the fact that the market price of other gas still subject to regulation under different sections of the NGPA was substantially below the statutorily prescribed ceilings. *Id.* at 22,195-22,198 (J.A. 115-127).

2. The Commission also included in Order No. 451 important protections for pipelines and other purchasers. By virtue of this Court's decision in *United Gas Pipe Line Co.* v. *Mobile Gas Serv. Corp.*, 350 U.S. 332 (1956), a producer could not charge the higher rate permitted by the Commission's new ceiling in Order No. 451 unless its contract with the purchaser permitted the increase. However, the Commission recognized that many existing gas contracts contained indefinite price-escalation clauses, under which the price the purchaser was obligated to pay could rise to the maximum lawful price allowed by the Commission under the NGA and the NGPA. In the Commission's view, producers that were parties to such contracts should not automatically be entitled to receive the new ceiling price, because the ceiling would then become a floor and the natural gas market would be subject to the same sorts of distortions that led to enactment of the NGPA. 51 Fed. Reg. at 22,204 (J.A. 141). Ac-

cordingly, the Commission conditioned a producer's right to collect higher rates under Order No. 451 upon the producer's entering into a voluntary agreement with the existing purchaser to that effect or its invocation of a structured "Good Faith Negotiation" (GFN) procedure prescribed by Order No. 451. See generally *id.* at 22,204-22,209, 46,784-46,802 (J.A. 141-163, 295-367).

The GFN procedure, which is codified at 18 C.F.R. 270.201 (App., *infra*, 7a-16a), consists of several steps. First, a producer may request a purchaser to nominate the price at which it would be willing to continue to purchase old gas under one or more contracts between the parties. 18 C.F.R. 270.201(b)(1). However, such a request is deemed to constitute an offer by the producer to release the purchaser from its contractual obligation to purchase any gas sold under *any* existing contract between the two parties that includes the sale of old gas (not merely the contract(s) named in the producer's request). 18 C.F.R. 270.201(b)(4). Upon receipt of the producer's request, the purchaser not only may nominate a price at which it would continue to purchase gas under the contract(s) specified by the producer, but also may make a counter-request of the *producer* to nominate a price at which the *producer* would be willing to continue selling any gas (old or new) under any contracts specified by the purchaser that cover at least some old gas. 18 C.F.R. 270.201(b)(2).

If, after the nominations, the producer and the purchaser are unable to agree on a new price for gas covered by an existing contract, the producer must continue sales to the purchaser at the same price, although it may abandon its contract service obligations to that purchaser if (1) it has executed a contract with another willing purchaser for the released gas, and (2) it furnishes at least 30 days' notice to the former pipeline-purchaser. See 18 C.F.R. 157.301, 270.201(c)(1) and (e)(4). But the purchaser has an important reciprocal right: if the producer does not agree to the price the purchaser nominates, the purchaser may terminate its purchase obligations under any of the contracts named in its counter-request. 18

C.F.R. 270.201(c)(2) and (f)(3). The GFN procedure thus serves as an inducement for both parties either to reach agreement on a new sales price or to release the gas for sale to others at market rates.

3. Finally, the Commission rejected suggestions by some commenters that it should use the Order No. 451 rulemaking as the vehicle for a comprehensive resolution of various issues raised by so-called "take-or-pay" clauses in natural gas contracts,[6] or should refrain from adopting Order No. 451 until the take-or-pay issue was finally resolved. The Commission reasoned that the effect of Order No. 451 would be to lower the overall market price of all gas, which would mitigate the pipelines' take-or-pay exposure. In addition, the Commission pointed out that it was addressing the take-or-pay issue in separate proceedings on Order No. 436,[7] which had already induced substantial settlements of pipelines' take-or-pay liabilities to producers, and that the GFN process, if invoked by a producer as a precondition to collecting higher rates for old gas, would have the salutary effect of encouraging renegotiation of many contracts to eliminate or modify the take-or-pay clauses. 51 Fed. Reg. at 22,174-22,175, 22,183, 22,196-22,197, 46,783-46,784 (J.A. 33-36, 66-69, 120-124, 292-295). Indeed, the Commission pointed out that the GFN procedure, permitting a purchaser to nominate a price it is willing to pay for all gas (old and new) under existing contracts and to terminate its contract obligation if the producer does not agree to that price,

[6] Such a clause requires a pipeline to take a specified volume of gas from a producer or, if it is unable to do so, to pay for the specified volume. See *Transco*, 474 U.S. at 412.

[7] Order No. 436, *Regulation of Natural Gas Pipelines After Partial Wellhead Decontrol*, 1982-1985 FERC Stats. & Regs. [Regs. Preambles] (CCH) ¶ 30,665 (1985), aff'd in part and remanded in part *sub nom. Associated Gas Distributors* v. *FERC*, 824 F.2d 981 (D.C. Cir. 1987), cert. denied, 485 U.S. 1006 (1988). The background of the take-or-pay problem and the Commission's subsequent measures to address it are explained in greater detail in our petition for a writ of certiorari (at 4-13) in *FERC* v. *Associated Gas Distributors*, petition for cert. pending, No. 89-2016 (filed June 22, 1990).

"provides the purchaser with a powerful additional bargaining card to negotiate a lower price for new gas in multi-vintage contracts." *Id.* at 22,197 (J.A. 122).

D. The Decision of the Court of Appeals

Numerous producers and purchasers of natural gas thereafter sought judicial review of Order No. 451 (as modified on rehearing by Order No. 451-A). With one exception, none of the respondents sought a stay of the final Order pending review, and the court of appeals denied the application by the one respondent (Williams Natural Gas) that did seek a stay. As a result, the new pricing system and Good Faith Negotiation procedure established by Order No. 451 were permitted to go into effect, and they have resulted in the renegotiation of numerous producer-pipeline contracts since that time. See 89-1452 Pet. 3, 13, 17-18, 26-27; 89-1453 Pet. 16, 26.

1. On September 15, 1989, a divided panel of the court of appeals held Order No. 451 invalid and vacated the Order in its entirety. Pet. App. 1a-60a. The court expressly did not suggest that the Commission was "misguided" in its conclusion that the disorder in the natural gas market had resulted, at least in part, from the vintage pricing structure for old gas. *Id.* at 20a. Nor did it overturn the Commission's finding that the higher ceiling price for old gas under Order No. 451 is "just and reasonable" within the meaning of the NGA. The court nevertheless held that the uniform ceiling price for all old gas under Order No. 451 is wholly beyond the Commission's statutory authority to prescribe. Pet. App. 16a-23a. The court dismissed the Commission's reliance on the express authorization in Sections 104(b)(2) and 106(c) to impose "higher" rates for old gas, as long as they are "just and reasonable," as a "somewhat ingenious application of the plain meaning rule of statutory construction." Pet. App. 21a. It instead believed that Sections 104(b)(2) and 106(c) should be read to confer only "limited authority" on the Commission, and would be "more appropriately interpreted as special relief measures to be utilized in the event that existing congressional ceiling prices become confiscatory." Pet. App. 22a-23a & n.24.

The court did not point to any statutory language that confines the Commission's authority under Sections 104 (b)(2) and 106(c) in this manner. Rather, in rejecting the Commission's approach, the court relied solely on floor statements by several Members of Congress concerning what the court believed to be the "essence" of the legislative compromise leading to enactment of the NGPA. Pet. App. 17a-20a & n.22. In its view, those floor statements (none of which addressed the Commission's authority under Sections 104(b)(2) and 106(c)) revealed a legislative intent to concentrate the rewards of higher prices solely on the development of new, high-cost gas and to guard against what the court labeled "de facto deregulation" of old gas prices. Pet. App. 17a. This legislative history, the court concluded, did not authorize the Commission to "break[] virgin ground" under the just and reasonable standard by "abrogating the vintage pricing structure" for old gas. *Id.* at 22a-23a & n.24.

The court also invalidated the provisions of Order No. 451 that permit a producer to abandon existing service obligations if it does not reach agreement with its pipeline customer on a new price under the GFN procedure. Pet. App. 24a-28a. The court acknowledged that the D.C. Circuit had found "no procedural objection" under Section 7(b) of the NGA, 15 U.S.C. 717f(b), to the Commission's identification, in an otherwise valid rule, of circumstances "which automatically trigger its approval of abandonment," and that the D.C. Circuit likewise had found it "well-established that the Commission need not hold an evidentiary hearing when no issue of material fact is in dispute." Pet. App. 26a (quoting *Associated Gas Distributors* v. *FERC*, 824 F.2d 981, 1015 n.17 (D.C. Cir. 1987), cert. denied, 485 U.S. 1006 (1988), and *Kansas Power & Light Co.* v. *FERC*, 851 F.2d 1479, 1484 (D.C. Cir. 1988)). The court nonetheless believed that the Commission "ha[d] abdicated its responsibility under Section 7(b) of the NGA" by pro-

viding abandonment authorization on a generic, rather than on a case-specific, basis and by placing undue reliance on the GFN procedure. Pet. App. 28a. Moreover, although the Commission pointed out that under Order No. 451, "prior abandonment approval has, in fact, been granted by the Commission," *id.* at 27a, the court perceived an inconsistency with *United Gas Pipe Line Co.* v. *McCombs*, 442 U.S. 529 (1979), in which this Court reversed an appellate decision that permitted a producer to abandon sales without any prior Commission approval. Pet. App. 27a-28a.

Finally, the court held that the Commission had erred in failing to resolve the problem of high-cost take-or-pay contracts in the context of Order No. 451, even though it recognized that the Commission was addressing the very same problem in separate proceedings. Pet. App. 29a-32a. The court was unpersuaded by the Commission's finding that the GFN procedure would ameliorate the problem in the context of this proceeding. *Id.* at 31a-32a. The court regarded the GFN procedure as too "one-sided" because it is initiated by the producer-seller and because, the court believed, it offers insufficient bargaining power to the pipeline-purchaser. *Ibid.*; see also *id.* at 24a n.26, 28a. The court reached this conclusion even though it elsewhere acknowledged that in the absence of the GFN procedure, a producer would automatically be entitled to receive the higher ceiling price under a price-escalation clause. *Id.* at 29a.[8]

[8] The majority also struck down the related requirement in Order No. 451 that a pipeline continue to transport old gas that is released from its contract with the producer and sold to another purchaser. Pet. App. 32a-35a; see 18 C.F.R. 270.201(h). As the majority acknowledged (Pet. App. 32a n.34), however, and as respondents concede (Br. in Opp. 12 n.6), the continuing transportation obligation is of little practical significance, because all of the major interstate pipelines have now applied for or accepted "blanket" transportation certificates obligating them to provide transportation service to all shippers on a non-discriminatory basis. 18 C.F.R. 284.8(b), 284.9(b), 284.221-284.226; see S. Rep. No. 38, 101st Cong., 1st Sess. 6 (1989). In these circumstances, no petitioner has sought further review of this transportation issue.

2. Judge Brown dissented. Pet. App. 36a-60a. He believed that the majority had improperly "[f]ail[ed] to accord to the [Commission] the expertise which Congress invests in it," "[o]verlook[ed] specific congressional language giving express legislative authority to raise the price of old gas," and "[s]ubstitute[d] its own judgment for that of the Commission on what Congress has ordained the Commission may do about the grave problems of the natural gas business." *Id.* at 36a-37a (emphasis omitted). In Judge Brown's view, "Congress could not have been more explicit in authorizing the Commission to raise statutory ceiling prices for committed or dedicated gas sales 'if such [higher] price is just and reasonable within the meaning of the [NGA].'" *Id.* at 47a (quoting 15 U.S.C. 3314(b)(2) and 3316(c)). "This means," he continued, "that Congress granted the Commission the express authority to raise the ceiling prices for vintage gas sales," and "[t]he sweeping nature of this legislative grant is reflected by expressly allowing this authority to be exercised 'by rule or order.'" Pet. App. 47a-48a. Judge Brown also was of the view that the price ceiling prescribed by the Commission is "just and reasonable" within the meaning of the NGA, since the record "fully supports" the Commission's judgment that "overall and in the long term prices would be lower than otherwise because of the increased supply of relatively lower-priced old gas into the open market competing with the more expensive, incentive-priced and deregulated gas." *Id.* at 50a.

Judge Brown further concluded that the pre-granted abandonment authorization in Order No. 451 is lawful, Pet. App. 52a-55a, because Section 7(b) of the NGA "does not require that the Commission act on such matters only case-by-case." *Id.* at 53a. Finally, he disagreed with the majority's direction to the Commission "to consider, and once and for all to *solve*, a matter so perplexing and complex as the issue of take-or-pay contracts." *Id.* at 57a. He pointed out that "reform may take one step at a time," *id.* at 59a (quoting *Williamson* v. *Lee Optical of Oklahoma, Inc.*, 348 U.S. 483, 489 (1955)),

and believed that Order No. 451 in any event "provides pipelines with the means to address take-or-pay problems" in negotiations under the GFN procedure. *Ibid.*

3. On January 16, 1990, this Court stayed the mandate of the court of appeals pending the timely filing and disposition of petitions for a writ of certiorari. No. A-503.

INTRODUCTION AND SUMMARY OF ARGUMENT

Order No. 451 is one of several major administrative measures adopted by the Federal Energy Regulatory Commission to address the artificial regional disparities, production disincentives, and other significant distortions that continued to plague natural gas production and distribution in the United States in the mid-1980s. After exhaustive analysis, the Commission concluded that the anachronistic, multi-tiered system of vintage pricing still in effect for "old" gas substantially contributed to these conditions, and it therefore concluded that vintage pricing should be eliminated.

Exercising its express authority under the NGPA to establish a higher ceiling price for old gas as long as it is "just and reasonable" within the meaning of the Natural Gas Act, the Commission collapsed the 15 different vintages of old gas into a single category to be covered by a single price ceiling. The ceiling the Commission chose was the one already in effect for one of the 15 vintages (post-1974 old gas). That ceiling previously had been found by the Commission to be "just and reasonable" for post-1974 gas in Order No. 770 ten years earlier, had been sustained by the D.C. Circuit on judicial review of Order No. 770 in *American Public Gas Ass'n* v. *FPC*, 567 F.2d 1016 (1977), cert. denied, 435 U.S. 907 (1978), and had been carried forward by Congress itself through Section 104(b)(1) of the NGPA. After thoroughly reexamining that rate (as adjusted for inflation in accordance with the NGPA), the Commission once again found it to be "just and reasonable," this time for all categories of old gas.

The Commission also adopted a balanced and carefully structured Good Faith Negotiation procedure that must be invoked by a producer as a condition precedent to demanding rates permitted by the higher price ceiling for old gas. This procedure was designed to assure that the ceiling did not unfairly prejudice pipelines that had agreed to open-ended price-escalation clauses (which otherwise would have permitted producers to collect higher rates on demand) and to afford pipelines significant leverage in resolving their liability under "take-or-pay" contracts with producers.

Order No. 451 has had a significant effect on the natural gas industry since it went into effect more than three years ago. It has led to the successful negotiation or renegotiation of numerous contracts between producers and pipelines, some of which address take-or-pay issues between the parties as well. Moreover, the Commission's projection when it issued Order No. 451 that the overall price of natural gas would decrease has proven to be accurate, as the natural gas market has become increasingly competitive. The court of appeals erred in now setting aside this important effort to reform the pricing structure for old gas.

I. The court of appeals did not disturb the Commission's expert judgment that the system of disparate vintage price ceilings for old gas no longer yielded rates that were "just and reasonable" within the meaning of the Natural Gas Act standard incorporated into the NGPA and that the single new ceiling adopted for old gas in Order No. 451 does, by contrast, satisfy that flexible standard. In any event, the Commission's judgment on these points is sound and exhaustively documented: the new ceiling was designed to bring about lower prices for consumers generally, create incentives to produce an additional 11 trillion cubic feet of old gas, reduce inequities among purchasers that had unequal access to old gas, and remove obstacles in the transition to the fully competitive market Congress envisaged.

Nevertheless, without pointing to any statutory provision that prohibits what the Commission did, the court

of appeals held that the Commission had exceeded its statutory authority for eliminating price vintaging. As a result, the court effectively removed from the Commission's regulatory jurisdiction the price ceilings that the Commission itself had put in place. And in doing so, it accorded a permanent and exalted status to the particular hodge-podge of price ceilings that happened to be in effect for a brief time in the midst of the far different and rapidly changing market and regulatory climate that immediately preceded passage of the NGPA almost 12 years ago. These perverse results cannot be squared with the text of Sections 104(b)(2) and 106(c) of the NGPA, which expressly incorporates the flexible "just and reasonable" standard of the Natural Gas Act, or with the experience under that standard preceding enactment of the NGPA, when the Commission, sustained by the courts, constantly revised the rates for these same categories of gas in response to changing market and other conditions. The court of appeals' holding thus is inconsistent with the Commission's broad mandate under the NGPA "to overse[e] a national market price regulatory scheme." *Transcontinental Gas Pipe Line Corp.* v. *State Oil & Gas Bd.*, 474 U.S. 409, 421 (1986).

II. The court of appeals likewise erred in invalidating the provisions of Order No. 451's Good Faith Negotiation procedure that specify in advance the conditions under which a producer is permitted by the Commission to abandon its contract service obligations to the purchaser. Section 7(b) of the Natural Gas Act provides that "[n]o natural gas company shall abandon * * * any service * * * without the permission and approval of the Commission first had and obtained, after due hearing, and a finding by the Commission * * * that the present or future public convenience or necessity permit such abandonment." Those requirements were satisfied here. The Commission gave its "permission and approval" for the abandonments covered by the Order, based on a finding that the "public convenience or necessity" would be served by releasing the gas to another purchaser when

the GFN procedure fails to result in an agreement between the parties. And because the relevant legislative-type facts supporting Order No. 451, including its abandonment component, were resolved in the rulemaking proceedings, no further hearing is "due" for relitigation of those issues in the context of each individual abandonment.

III. The court of appeals plainly overstepped its role by insisting that the Commission must comprehensively solve the problems created by "take-or-pay" clauses to which the pipelines themselves agreed before the Commission may exercise its express authority under the NGPA to raise the price ceiling for old gas. The court was apparently unaware of the extensive and largely successful undertakings by the Commission to address the take-or-pay problem, which have resulted in the settlement of current or future take-or-pay liabilities of pipelines to producers totalling approximately $44 billion. In any event, established principles of judicial review preclude the court of appeals from reordering the Commission's rulemaking proceedings and priorities.

IV. The soundness of the Commission's judgment in raising the ceiling price of old gas and instituting the related measures in Order No. 451 is confirmed by Congress's enactment of the Natural Gas Wellhead Decontrol Act of 1989, Pub. L. No. 101-60, § 2(b), 103 Stat. 158, which builds upon the Commission's efforts, including Order No. 451, to promote a fully competitive natural gas market.

ARGUMENT

I. THE ALTERNATIVE PRICE CEILING IN ORDER NO. 451 IS FULLY CONSISTENT WITH THE "JUST AND REASONABLE" STANDARD INCORPORATED INTO SECTIONS 104(b)(2) AND 106(c) OF THE NATURAL GAS POLICY ACT OF 1978

In holding that the Commission is without authority to revise the anachronistic system of vintage pricing for old gas, the court below disregarded the plain meaning of the relevant statutory provisions and the settled judicial construction of the "just and reasonable" standard that Congress incorporated into the Natural Gas Policy Act. Rather than seizing upon a few vague statements by individual Members of Congress to fashion an absolute barrier to the Commission's actions that appears nowhere in the Act, the court of appeals should have measured the price features of Order No. 451 against the principles developed under the "just and reasonable" standard that *does* appear in the Act. Under those principles, Order No. 451 is clearly valid.

A. The NGPA Expressly Authorizes The Commission To Adopt A "Higher" Ceiling Price For Old Gas Where, As Here, That Price Is "Just And Reasonable"

The starting point for any analysis of the Commission's statutory responsibilities is, of course, the language of the NGPA itself. "If the statute is clear and unambiguous, 'that is the end of the matter, for the court, as well as the agency, must give effect to the unambiguously expressed intent of Congress.'" *Sullivan* v. *Stroop*, 110 S. Ct. 2499, 2502 (1990) (quoting *K Mart Corp.* v. *Cartier, Inc.*, 486 U.S. 281, 291 (1988)). But if the statute is ambiguous, the court must defer to a reasonable administrative interpretation. *Chevron U.S.A. Inc.* v. *NRDC, Inc.*, 467 U.S. 837, 843-844 (1984); see *Pension Benefit Guaranty Corp.* v. *LTV Corp.*, No. 89-390 (June 18, 1990), slip op. 12-17. Even greater deference is required where, as here, Congress has charged an agency with giving more particularized content to broad statutory standards by issuing rules having legislative effect. *Atkins* v. *Rivera*, 477 U.S. 154, 162 (1986); see also *Sullivan* v. *Zebley*, 110 S. Ct. 885, 890 (1990). And in the special area of ratemaking, "the breadth and complexity of the Commission's responsibilities demand that it be given every reasonable opportunity to formulate methods of regulation appropriate for the solution of intensely practical difficulties." The Commission's orders therefore "may not be overturned if they produce 'no arbitrary result.'" *Permian Basin*, 390 U.S. at 790.

Here, as in the Court's last case arising under the NGPA, "[t]he plain meaning of the statute decides the issue presented." *FERC* v. *Martin Exploration Management Co.*, 486 U.S. 204, 209 (1988). Sections 104 and 106 of the NGPA unambiguously authorize the Commission to increase the ceiling price for old gas and interstate rollover gas "whenever traditional NGA principles would dictate a higher price." *Mid-Louisiana Gas*, 463 U.S. at 333. By contrast, the text of those Sections lends no support whatever to the court of appeals' view that Congress withheld that broad authority from the Commission and instead froze the prior system of vintage pricing. If the court of appeals had any doubt on this score, however, it should have deferred to what is, at the very least, a permissible interpretation of the relevant statutory provisions by the expert agency charged with their administration.

1. Section 104(b)(1)(A)(i) and (ii) of the NGPA provides that the maximum ceiling price for old gas shall be the "just and reasonable rate * * * established by the Commission which was * * * applicable to the first sale of such natural gas on April 20, 1977," adjusted by an inflation factor for each month since April 1977. 15 U.S.C. 3314(b)(1)(A)(i) and (ii); see § 101, 15 U.S.C. 3311.[9] Section 106(a)(1) similarly provides that the ceil-

[9] The NGPA also carries forward any "just and reasonable rate" established by the Commission after April 27, 1977, but before the NGPA's effective date. 15 U.S.C. 3314(b)(1)(B). This provision is of little practical significance.

ing price for gas covered by an interstate rollover contract shall be "the just and reasonable rate, if any, * * * established by the Commission" for the gas on the effective date of the NGPA. 15 U.S.C. 3316(a)(i).[10] By enacting these provisions, Congress carried forward for the time being the ceiling price for each of the various vintages listed in the Commission's regulations at the time the NGPA was enacted.

Congress did not, however, mandate that the ceilings based on those grandfathered rates (as adjusted for inflation) remain permanently fixed. To the contrary, it expressly authorized the Commission to prescribe a different ceiling for old gas, just as it was free to do under the NGA before the NGPA was enacted. Section 104(b)(2) of the NGPA provides (15 U.S.C. 3314(b)(2)):

> **Ceiling prices may be increased if just and reasonable.** The Commission may, by rule or order, prescribe a maximum lawful ceiling price, applicable to any first sale of any natural gas (or category thereof, as determined by the Commission) otherwise subject to the preceding provisions of this section, if such price is—
>
> (A) higher than the maximum lawful price which would otherwise be applicable under such provisions; and
>
> (B) just and reasonable within the meaning of the Natural Gas Act.

Section 106(c) of the NGPA, 15 U.S.C. 3316(c), which governs interstate rollover contracts, is essentially identical.

The only restrictions on the Commission's authority under Sections 104(b)(2) and 106(c) are: (1) any revised ceiling price prescribed by the Commission must be "higher" than the applicable grandfathered rate (as adjusted for inflation), and (2) the higher rate must be "just and reasonable within the meaning of the Natural

[10] Section 106(a)(2) provides an alternative ceiling of $0.54 per million Btu's if that is higher than the rate previously established by the Commission. 15 U.S.C. 3316(a)(2).

Gas Act." Both of these requirements were satisfied here. First, the single ceiling price adopted by the Commission in Order No. 451 is "higher" than each of the ceilings carried forward by Sections 104(b)(1) and 106(a)—except, of course, for post-1974 old gas, for which the ceiling price remains the same.

Second, the Commission found, after extensive analysis, that the higher ceiling price is "just and reasonable" within the meaning of the Natural Gas Act. See pages 11-13, *supra*. The price ceiling selected by the Commission for all old gas is not an arbitrary number without any relation to costs or prior ratemaking practices. The Commission collapsed all of the pre-NGPA vintages of old gas into a single vintage subject to a single price ceiling that the Commission, employing traditional NGA principles of "just and reasonable" ratemaking, had *already* found to be a "just and reasonable" price, for gas having a post-1974 vintage. That determination, in Order No. 770, was sustained by the D.C. Circuit in *American Public Gas Ass'n* v. *FPC*, *supra*, and was carried forward by Congress itself in Section 104(b)(1) of the NGPA. The Commission rationally determined that this ceiling, as periodically adjusted upward for inflation, did not become any less "just and reasonable" simply because market prices had since dipped below that level, presumably to the benefit of consumers. See *Martin Exploration*, 486 U.S. at 208 ("by 1984 the market price of natural gas had plunged below the regulated price ceilings").[11] And because the rationale for estab-

[11] There is no merit to respondents' contention (Br. in Opp. 21-23) that the Commission engaged in impermissible "*de facto* deregulation" because the ceiling now is above the market price for natural gas. *All* old gas remains subject to a regulated price ceiling, which may later be adjusted if necessary to assure just and reasonable rates. 51 Fed. Reg. at 22,211, 46,764-46,765 (J.A. 170-171, 219-222). That is all the NGA and NGPA require. Indeed, the ceiling price for post-1974 old gas that is carried forward by Section 104(b)(1), which stood at $2.94 as of April 1990 (18 C.F.R. 271.101 (Table II), at 376 (1990)), is above the market price; and the Commission cannot lower that ceiling because Section 104(b)(2)

lishing different ceilings for the other vintages of old gas had long since disappeared, it was not arbitrary for the Commission to conclude that *all* of those other vintages should now be brought under this same price ceiling. That is especially so since the uneven access of different pipelines and consumers to low-cost old gas, which was in many instances an "historical accident," *American Public Gas Ass'n* v. *FPC*, 567 F.2d at 1058, had led to widely divergent prices for consumers and had seriously distorted the increasingly competitive market for natural gas at the wellhead—consequences that the Commission permissibly could determine were neither "just" nor "reasonable."

The Commission also explained that the price ceiling for post-1974 gas that it was extending to all old gas approximated the "replacement cost" of that gas, which, in the current setting, corresponds to a "just and reasonable" price ceiling. Although that ceiling exceeded the then-prevailing market price, the Commission concluded that from a long-term, national perspective, permitting producers to bargain for a price for old gas up to its replacement cost would satisfy the NGPA's overriding objective of assuring an adequate supply of natural gas at fair prices and, in particular, would result in production of an additional 11 trillion cubic feet of old gas. In the Commission's judgment, as more of this relatively

requires that any revised ceiling be "higher." See Pet. App. 23a n.24; see also *Mid-Louisiana Gas*, 463 U.S. at 333. It could not seriously be maintained that post-1974 gas has for this reason become "deregulated." There is no reason for a different conclusion with respect to the other old gas to which the Commission has extended that same ceiling.

The decline in market prices recognized in *Martin Exploration* did, however, restrict the Commission's options once it concluded that the old gas vintage price structure no longer was just and reasonable. The Commission could not have collapsed all of the vintage categories into a single category subject to a ceiling at or below the market price of old gas without lowering the ceilings applicable to the most recent (and highest-priced) vintages, which would have violated the requirement in Sections 104(b)(2) and 106(c) that any new ceiling be "higher."

low-cost old gas began to compete with higher-cost "new" and "hard-to-produce" gas, market forces ultimately would drive *overall* gas prices down. See pages 11-13, *supra*. As respondents concede (Br. in Opp. 9 n.5), the Commission's projection of lower overall prices has proven to be accurate. Although the price of old gas has risen in the short term (as the Commission expected when it issued Order No. 451), the national average wellhead price for *all* natural gas declined from $1.94 per Mcf in 1986 to $1.71 per Mcf in 1989. Energy Information Administration, Dep't of Energy, *Natural Gas Monthly*, at 32 (Table 4) (Mar. 1990).

2. The court of appeals did not attempt to refute either the Commission's exhaustive analysis and findings in Order No. 451 or the Commission's conclusion that the approach it adopted was just and reasonable under traditional NGA principles. In fact, the court expressly did *not* suggest that the Commission was "misguided" in concluding "that the disorder in the natural gas market has resulted, at least in part, from the NGPA's vintage pricing structure which compelled natural gas producers to sell gas at below replacement costs," Pet. App. 20a, and it grudgingly acknowledged that the Commission's solution to the pervasive problems besetting the natural gas industry as a result was "arguably meritorious." *Id.* at 23. But the court believed Congress had tied the Commission's hands and prevented it from implementing that solution.

In the court of appeals' view, Sections 104(b)(2) and 106(c) must be read to permit the Commission to adopt a higher price ceiling only in "narrow[]" circumstances where necessary to grant "special relief," such as where the rate permitted by the price ceiling would otherwise be confiscatory. Pet. App. 22a n.24. Nothing in those provisions supports the Court's crabbed construction. To the contrary, both Sections state that the Commission may prescribe a higher maximum lawful price "applicable to *any* first sale of natural gas" governed by those provisions, so long as the new ceiling is "just and reasonable." 15 U.S.C. 3314(b)(2), 3316(c) (emphasis

added). Congress's use of the word "any" makes clear that the Commission's regulatory jurisdiction over old gas prices is all-encompassing. Compare *United States* v. *Monsanto*, 109 S. Ct. 2657, 2662 (1989); *Public Employees Retirement System* v. *Betts*, 109 S. Ct. 2854, 2864 (1989). Moreover, because the single ceiling price the Commission selected in Order No. 451 had been found to be "just and reasonable" when it was first adopted in 1976, and because it has been adjusted regularly for inflation ever since, it is difficult to see how it could ever become confiscatory. Congress therefore must have had some purpose other than special relief in mind when it enacted Sections 104(b)(2) and 106(c).

In addition, as Judge Brown pointed out in dissent, the "sweeping nature" of Sections 104(b)(2) and 106(c) is also reflected in their authorization for the Commission to proceed "by rule or order." Pet. App. 48a. Since the "[e]xercise of this power is not confined to case-by-case rate making," it is "entirely appropriate for it to be used and employed generically." *Ibid.*[12] The broad scope of the Commission's discretion is further reinforced by the fact that both Sections permit a higher price ceiling for any "category" of old gas, "as determined by the Commission."

B. The Settled Judicial Construction Of The "Just And Reasonable" Standard When It Was Incorporated Into The Natural Gas Policy Act Strongly Supports The Commission's Revision Of The Vintage Pricing System For Old Gas

More fundamentally, the court of appeals' narrow construction of the Commission's authority under Sections 104(b)(2) and 106(c) wholly ignores the significance of the standard by which the Commission's exercise of its

[12] As Judge Brown also observed, Pet. App. 48a n.7, the Fifth Circuit previously had recognized, in a related context, that "[t]he drafters' choice of the words 'rule or order' * * * clearly contemplates the establishment of an industry-wide scheme." *Texas Eastern Transmission Corp.* v. *FERC*, 769 F.2d 1053, 1061 (5th Cir. 1985), cert. denied, 476 U.S. 1114 (1986).

authority is to be governed. As respondents concede (Br. in Opp. 19): "The 'just and reasonable' standard that Congress borrowed from the NGA and incorporated into the NGPA was familiar statutory language that carried with it a regulatory scheme well-known to Congress, the Commission, and the industry." Congress therefore must be understood to have intended that the "just and reasonable" standard would be interpreted in the same manner in the NGPA. See *Merrill Lynch, Pierce, Fenner & Smith, Inc.* v. *Curran*, 456 U.S. 353, 378-382 (1982); *Cannon* v. *University of Chicago*, 441 U.S. 677, 699 (1979); *Morissette* v. *United States*, 342 U.S. 246, 263 (1952).

1. As we have explained (see pages 3-5, *supra*), prior to enactment of the NGPA, the "just and reasonable" standard had been repeatedly construed by the Commission and the courts, including this Court, to accord the Commission a broad measure of flexibility and discretion. The court of appeals' construction of Sections 104(b)(2) and 106(c) to prohibit the Commission from departing from vintage pricing under the "just and reasonable" standard in those Sections cannot be reconciled with settled precedent.

For example, this Court had made clear since the earliest days of the NGA that the "just and reasonable" standard does not bind the Commission "to the use of any single formula or combination of formulae in determining rates" and that "[u]nder the statutory standard of 'just and reasonable,' it is the result reached not the method employed which is controlling." *Hope Natural Gas Co.*, 320 U.S. at 602; see also *FPC* v. *Natural Gas Pipeline Co.*, 315 U.S. 575, 586 (1942); *Wisconsin* v. *FPC*, 373 U.S. 294, 309 (1963); *Permian Basin*, 390 U.S. at 776-777; *FPC* v. *Texaco, Inc.*, 417 U.S. 380, 386-389 (1974).

These principles were given particular emphasis in decisions of this Court reviewing wellhead rates. In *Wisconsin* v. *FPC*, the Court held that the NGA's "just and reasonable" standard does not compel unwavering ad-

herence to the individual cost-of-service method of setting rates, and it did so in terms that are fatal to the court of appeals' view that the Commission cannot depart from the system of vintage pricing for old gas (373 U.S. at 309):

> [T]o declare that a particular method of rate regulation is so sanctified as to make it highly unlikely that any other method could be sustained would be wholly out of keeping with this Court's consistent and clearly articulated approach to the question of the Commission's power to regulate rates.

See also *Permian Basin*, 390 U.S. at 767, 800; *FPC* v. *Texaco*, 417 U.S. at 386-393.

What is more, prior to enactment of the NGPA, this Court had repeatedly sustained the Commission's authority to require *all* purchasers to bear part of the future costs of exploring for and developing additional reserves of natural gas—one of the principal justifications for the Commission's departure from vintage pricing in Order No. 451. Thus, in *Mobil Oil Corp.* v. *FPC*, the Court rejected the contention that the price previously established for the first vintage of gas from the Southern Louisiana producing area could not later be increased in the absence of evidence of increased costs (417 U.S. at 320):

> As between placing the burden of [expanding future production] on new or second vintage gas alone or spreading it over both old and new gas, [the Commission] judged the latter more equitable and more likely to lead to the immediately increased capital necessary in the face of a crisis. We see nothing * * * to suggest that the Commission could not * * * place the burden of those payments on all users rather than on those alone who purchased gas in the future.

See also *FPC* v. *Texaco Inc.*, 417 U.S. at 388 (encouraging exploration "obviously involve[s] the rate structure and implie[s] a broad discretion for the Commission"); *Permian Basin*, 390 U.S. at 797. This consideration has even greater force here, because the Commission deter-

mined that vintage pricing should be eliminated and higher rates allowed in order to encourage production of vast reserves of *old* gas that would otherwise go undeveloped.

Finally, the history of the vintage pricing scheme itself refutes the court of appeals' notion that it is an integral component of the "just and reasonable" standard incorporated into the NGPA for old gas. The Commission did not adopt vintage pricing until 1960—more than two decades after enactment of the NGA and its "just and reasonable" standard—and the Commission anticipated at the time that the vintage approach would be only a temporary measure and would be phased out when circumstances changed. See *Statement of General Policy*, No. 61-1, 24 F.P.C. 818, 819 (1960). In fact, as the Court noted in *Mid-Louisiana Gas*, the Commission, prior to enactment of the NGPA, had "shift[ed] from a pure historical-cost-based to an incentive-price-based approach, * * * and * * * temporarily abandon[ed] the practice of vintaging." 463 U.S. at 330 & n.10; see pages 5-6, *supra*. Both the Fifth and D.C. Circuits had upheld substantial modifications of the vintage pricing system (including the institution of replacement-cost methodology) against claims that they violated the "just and reasonable" standard of the NGA. See *Tenneco Oil Co.* v. *FERC*, 571 F.2d at 841-842, 847-848; *American Public Gas Ass'n* v. *FPC*, 567 F.2d at 1033-1034, 1057-1058; *Shell Oil Co.* v. *FPC*, 520 F.2d at 1077-1078; *Shell Oil Co.* v. *FPC*, 491 F.2d at 86-88. And just a few months prior to enactment of the NGPA, the Fifth Circuit approved a Commission order—which collapsed the pre-1973 vintages of "flowing gas" into a single category subject to a single ceiling price based on the historical costs incurred in the most recent (and highest-cost) test year—that is remarkably similar to the Order invalidated by the same court in this case. See *Tenneco Oil*, 571 F.2d at 837-838, 841-842; page 7, *supra*.

It is the vintage price ceilings sustained by *Permian Basin* and the court of appeals decisions just discussed

that Congress carried forward in Sections 104(b)(1) and 106(a) of the NGPA, expressly recognizing in the statutory text that each was a "*just and reasonable* rate * * * established by the Commission" under the NGA. 15 U.S.C. 3314(b)(1), 3316(a) (emphasis added). Congress therefore must have intended the Commission to have at least the same degree of discretion it was found to have in *Permian Basin* and the appellate decisions to revise the natural gas rates—including the vintage-pricing system—under the "just and reasonable" standard carried forward in Sections 104(b)(2) and 106(c).

2. The court of appeals' only response to Congress's explicit incorporation of the "just and reasonable" standard into Sections 104(b)(2) and 106(c) was to label the Commission's reliance on the plain meaning of that incorporation as "somewhat ingenious." Pet. App. 21a. But the court never suggested what that standard might mean if it does not confer the sort of flexibility and discretion that the Commission exercised here. It simply asserted that the system of multiple-vintage pricing in effect when Congress passed the NGPA was too "significant [a] feature of the NGPA's design" to be abrogated by the Commission, *id.* at 22a-23a, and thereby essentially read out of the NGPA the "just and reasonable" language upon which the Commission relied in consolidating all old gas into a single vintage.

Contrary to the court of appeals' view, however, although the various rates in effect in 1978 happen to have been based on a multiple-vintage approach to ratemaking, nothing in the NGPA suggests that it froze that particular approach (or the price ceilings it once yielded) for all time. Sections 104 and 106 in fact make no mention of vintage pricing or any other ratemaking methodology. They merely continue in effect the "just and reasonable *rate* * * * established by the Commission" for old gas, 15 U.S.C. 3314(b)(1), 3316(a) (emphasis added)—*i.e.*, the end result of the Commission's application of the vintage-pricing methodology it employed (albeit unevenly) during the early 1970's. See *Hope*

Natural Gas, 320 U.S. at 602. Because the just and reasonable standard does not require the Commission to follow any particular methodology in setting rates, Congress's decision to carry forward a particular "rate" (subject to a subsequent increase under the just and reasonable standard) does not imply that the underlying methodology has become part of the NGPA and therefore binding on the Commission.

At bottom, the court of appeals' refusal to give effect to the "just and reasonable" language Congress enacted was driven by the court's belief that "Congress' intent was, as it has been in the past, to protect the interests of consumers through incorporation of a vintaged old gas pricing scheme." Pet. App. 22a. But as we have just explained, the protection Congress afforded consumers derives not from a supposed incorporation of the vintaged-pricing scheme, of which there is no suggestion in the NGPA, but rather from Congress's express incorporation of the broad "just and reasonable" standard.

There is a deeper flaw, moreover, in the court of appeals' decision to construe Sections 104(b)(2) and 106(c) far more narrowly than their language permits in order to further what it understood to be Congress's "intent" to "protect the interests of consumers." The Court has recognized the dangers of that approach even where Congress has acted with a singular purpose: "[N]o legislation pursues its purposes at all costs. Deciding what competing values will or will not be sacrificed to the achievement of a particular objective is the very essence of legislative choice—and it frustrates rather than effectuates legislative intent simplistically to assume that *whatever* furthers the statute's primary objective must be the law." *Rodriguez* v. *United States*, 480 U.S. 522, 525-526 (1987). The point has even greater force here, because the "just and reasonable" standard has always been understood to require the Commission to consider a variety of interests, not merely those of consumers (or a particular group of consumers), in fixing or reviewing rates.

In any event, the court of appeals' premise that Sections 104 and 106 embody an unqualified commitment to maintaining the lowest possible prices for the particular pipelines and consumers that were fortunate enough to have access to ample supplies of old gas is refuted by the text of those Sections. Both Sections provide for *automatic* inflation adjustments in the ceiling price for old gas, whether or not the resulting increases are justified by the producer's historical costs. And both Sections authorize the Commission to adopt a different ceiling price only if it is *higher* than the one carried forward by the NGPA. If Congress was as single-minded in its determination to assure the lowest possible price as the court of appeals believed, it surely would have permitted the Commission to lower the ceiling prices in appropriate circumstances as well.

C. The Legislative History Does Not Support The Court Of Appeals' Interpretation Of Sections 104 And 106

The court of appeals attempted to avoid the force of the statutory text and its historical background by relying on isolated statements by several Members of Congress during the floor debates on the NGPA. Pet. App. 17a-20a & n.22. This Court has repeatedly stated, however, that "'[a]bsent a clearly expressed legislative intention to the contrary,' the words of the statute are conclusive." *Hallstrom* v. *Tillamook County*, 110 S. Ct. 304, 310 (1989) (quoting *CPSC* v. *GTE Sylvania, Inc.*, 447 U.S. 102, 108 (1980)). Here, the court of appeals pointed to no clearly expressed legislative intention suggesting that the term "just and reasonable" in Sections 104(b)(2) and 106(c) should be interpreted in a manner that departs so drastically from its settled meaning in the NGA.

The floor statements upon which the majority relied consist largely of general descriptions of the uncontroverted political compromises that led to enactment of the NGPA and of the NGPA's policies of protecting consumers while offering sufficient incentives for the pro-

duction of additional gas. Those statements—none of which specifically addressed the scope of the Commission's authority under Sections 104(b)(2) and 106(c)—are fully consistent with the Commission's approach in Order No. 451. The NGPA ultimately protects consumers of old gas not by permanently freezing whatever prices and pricing system happen to have been in effect for old gas at the time of enactment of the NGPA, but by carrying forward the "just and reasonable" standard of regulation that previously had been applied to the same gas under the NGA.

Moreover, as the Commission observed, 51 Fed. Reg. at 46,765 (J.A. 220), other portions of the NGPA's legislative history, which were not cited by the court below, demonstrate that Congress was aware of the broad and flexible authority vested in the Commission under the "just and reasonable" standard incorporated into Sections 104(b)(2) and 106(c) of the NGPA. For example, Senator Abourezk found it "critical to point out that [the NGA] does not require that the price set by the FERC be cost-based, except that, in the absence of full cost justification, the FERC must show the tangible benefits to consumers. This is the 'end result test' established in FPC against Hope Natural Gas Co." 124 Cong. Rec. 30,018 (1978). He also observed that "[n]othing prevents FERC setting the rates at whatever level is necessary actually to elicit new supply." *Ibid.* Senator Kennedy similarly observed that the Commission enjoyed the authority under the NGA "to establish prices which will bring forth gas at a 'just and reasonable' price and to vary that price according to conditions." *Id.* at 30,023.

The court of appeals' reading of the legislative history also ignores the origins of the "just and reasonable" standard in Sections 104(b)(2) and 106(c) as finally enacted. The bill passed by the House of Representatives would have extended controls for new gas, *Mid-Louisiana Gas*, 463 U.S. at 331, but would have effectively frozen the maximum lawful price of old natural gas on the basis of the applicable just and reasonable price established by the Commission as of April 1977 (as adjusted

for inflation). The House bill contained no provision for subsequent increases in the price ceiling for old gas; a producer could collect a higher price only under a special relief provision for high-cost gas.[13] By contrast, the bill passed by the Senate would have deregulated new gas in the near future, but "would have maintained Natural Gas Act regulation for all gas sold or delivered in interstate commerce before January 1, 1977." *Mid-Louisiana Gas*, 463 U.S. at 331.[14] Under the Senate bill, the Commission plainly would have retained the authority it had under the NGA's "just and reasonable" standard to abandon vintage pricing. The bill reported by the Conference Committee and enacted into law was a hybrid: it incorporated from the House bill the concept of statutory price ceilings for old gas based on the just and reasonable rates established by the Commission in April 1977, but it incorporated from the Senate bill the retained power of the Commission to modify those ceilings (but only to make them higher) under the just and reasonable standards of the NGA. Thus, Congress rejected an approach to regulation of old gas that would have frozen prices in the way the court of appeals construed Sections 104(b)(2) and 106(c) to require. The court, in short, "read too much into * * * scattered bits of legislative history." *Pennhurst State School* v. *Halderman*, 451 U.S. 1, 20 (1981).

II. THE COMMISSION WAS AUTHORIZED BY SECTION 7(b) OF THE NATURAL GAS ACT TO SPECIFY IN ORDER NO. 451 THE CIRCUMSTANCES UNDER WHICH FUTURE ABANDONMENT OF GAS SERVICE IS PERMITTED

The court of appeals also erred in invalidating the abandonment provision of Order No. 451, which is an integral component of the Good Faith Negotiation (GFN)

[13] H.R. 8444, 95th Cong., 1st Sess. §§ 405, 409 (1977), 123 Cong. Rec. 26,169 (1977); see H.R. Rep. No. 496, 95th Cong., 1st Sess. Pt. 4, at 104-106 (1977).

[14] See S. 2104, 95th Cong., 1st Sess. § 3 (1977), as amended, 123 Cong. Rec. 32,306 (1977).

procedure and, indeed, of the entire rulemaking package. Pet. App. 24a-28a. Under Order No. 451, a producer may abandon its service obligation to the purchaser under an existing contract only if the purchaser elects not to continue buying the gas in question, and only if the producer has entered into a contract to sell the same gas to another purchaser, which ensures that the gas will remain in the interstate market. See pages 14-15, *supra*. The Commission reasonably concluded that where these conditions are satisfied among the parties directly concerned, the producer should be permitted to abandon its service obligations to the prior customer so that it may begin to serve its new customer.

The NGPA "comprehensively and dramatically" changed the wellhead price regulation of natural gas sales. *Mid-Louisiana Gas*, 463 U.S. at 322. The NGPA did not, however, relieve the Commission of its responsibility under the NGA to regulate the non-price features of most old gas sales. Of particular relevance here, the NGPA left unaltered the requirement in Section 7(b) of the NGA, 15 U.S.C. 717f(b), that natural gas, once "committed or dedicated" to interstate commerce, must continue to flow in interstate commerce until the Commission authorizes the "abandonment" of that service. Specifically, Section 7(b) provides that "[n]o natural-gas company shall abandon * * * any service * * * without the permission and approval of the Commission first had and obtained, after due hearing, and a finding by the Commission * * * that the present or future public convenience or necessity permit such abandonment." Order No. 451 complies with these express requirements of Section 7(b) in every respect. The Commission so concluded after thoroughly considering the scope of its Section 7(b) authority when it issued Order No. 451. See 51 Fed. Reg. at 22,171-22,172, 22,205-22,206, 46,785-46,787 (J.A. 21-23, 147-149, 301-309). That reasonable interpretation of the NGA by the agency charged with its administration is entitled to considerable deference.

A. In Order No. 451, the Commission expressly gave the "permission and approval" required by Section 7(b)

for the abandonments of service covered by the Order, although it conditioned its approval upon the future occurrence of several protective conditions: (1) the inability of the producer and the purchaser to reach agreement on a revised price for old gas within the framework of the GFN procedure; (2) the producer's execution of a new contract to sell the released gas to a new purchaser; and (3) the purchaser's receipt of at least thirty days' notice of contract termination. See 18 C.F.R. 270.201(c)(1), (e)(3) and (4), and (f)(5). This Court specifically held in *FPC* v. *Moss*, 424 U.S. 494 (1976), that Section 7(b) authorizes the Commission to give advance approval of an abandonment.[18]

B. The Commission also made the requisite findings under Section 7(b) that, within the context of Order No. 451 as a whole, the "present and future public interest or necessity permit [such] abandonment." 51 Fed. Reg. at 46,785-46,787 (J.A. 301-306). First, the abandonment provision is but one feature of the Good Faith Negotiation procedure, which was designed to serve the public interest by protecting purchasers of gas under contracts having indefinite price-escalation clauses against the automatic price increases they otherwise would experience as a result of Order No. 451's higher price ceiling for old gas. The right of the producer to abandon service if the parties cannot reach agreement on a new price prevents the purchaser from exploiting the special protection afforded it by the GFN procedure by refusing to bargain in good faith.

The Commission further concluded that where the producer and purchaser cannot reach agreement under the GFN procedure for the continued sale of gas at a new price, the public interest would be served by making

[18] The court of appeals was mistaken in believing that the abandonment provisions of Order No. 451 conflict with *United Gas Pipe Line Co.* v. *McCombs*, 442 U.S. 529 (1979). Pet. App. 27a. There, the Commission had failed altogether to give its "permission and approval" for the abandonment at issue, and therefore it had not made an express finding that the public convenience or necessity favored that abandonment.

prompt provision for the sale of that gas to another purchaser, in order to ensure that the public will have adequate supplies of natural gas.[19] This finding represents a legitimate application of the Commission's policy that the propriety of abandonment depends upon a comparison of the individual needs of current gas consumers being served by the gas reserves against the overall needs of the natural gas market in seeing that those reserves remain dedicated to interstate commerce. 51 Fed. Reg. at 46,786 (J.A. 303-306); see *Consolidated Edison Co. of New York* v. *FERC*, 823 F.2d 630, 632 (D.C. Cir. 1987) ("the statutory 'public convenience or necessity' language frees [the Commission] to develop new policies to accommodate a shifting energy marketplace"); *Felmont Oil Corp.*, 33 F.E.R.C. ¶ 61,333, at 61,657 (1985), rev'd on other grounds *sub nom. Consolidated Edison Co.* v. *FERC*, 823 F.2d 630 (D.C. Cir. 1987). As Judge Brown aptly noted in his dissent, "Order No. 451 would be a meaningless exercise if, despite the Commission's finding that the vintage pricing system was unjust and unreasonable, pipelines with dominant market power could nevertheless effectively nullify GFN and shut in the gas or otherwise prevent increased supplies from reaching the market at a competitive price." Pet. App. 52a. By the same token, the Commission concluded that "generally a purchaser's loss of gas under abandonment provisions of the good faith negotiation rule should not cause it, or the market it serves, to experience a shortage of supply," because in light of

[19] The Commission summarized these points on rehearing (51 Fed. Reg. at 46,785 (J.A. 302)):

> [A]bandonment under the good faith negotiation rule is in the public interest, since it is necessary to ensure that the goals of Order No. 451 of increased production of old gas and overall lower prices * * * are achieved. These goals cannot be achieved unless producers can obtain the market-responsive prices permitted by the rule. Without the possibility of abandonment, purchasers under existing contracts could prevent producers from obtaining those prices by insisting on continuation of the present price.

market-responsive prices of new gas and the elimination of shortages, purchasers should have no difficulty finding alternative sources of supply. 51 Fed. Reg. at 46,786 (J.A. 304).

The court of appeals nevertheless believed that the GFN process and the conditions for abandonment are "one-sided" and producer-oriented. Pet. App. 24a n.26, 28a, 31a-32a. The court failed to appreciate the purchaser's decisive role in the GFN process and the circumstances that trigger it. First, the GFN procedure was included in the Order to protect *purchasers* from the consequences of automatic price-escalation clauses. Second, once the GFN process is triggered, if the purchaser signals an intent to continue to purchase old gas at a mutually agreed-upon price, the producer cannot "unilaterally" abandon sales. See *id.* at 59a (Brown, J., dissenting) (recognizing that the GFN process affords pipeline-purchasers "substantial bargaining leverage"). Third, the purchaser may often realize substantial benefits under the GFN process, because it has an opportunity to reopen the price terms of any contract with the producer that involves the sales of some old gas, including contracts that expose the purchaser to take-or-pay liability. Fourth, the purchaser has an important reciprocal right that corresponds to the producer's right of abandonment: once the produced triggers the GFN process, the purchaser has the right to terminate any contracts between the parties that cover at least some old gas, if the parties do not reach agreement on a new price to be paid for gas under them. For these reasons, the court's concerns about the fairness of the GFN and abandonment process are unfounded and do not undermine the Commission's "public interest or necessity" determination.

C. Finally, the Commission's grant of permission to abandon contract service in the circumstances specified in Order No. 451 is fully consistent with the phrase "after due hearing" in Section 7(b). The court below cited that phrase in support of its conclusion that Section 7(b) requires the Commission to conduct "case specific" inquiries into the merits of each individual abandonment application. Pet. App. 26a-28a. As the Commission observed when it issued Order No. 451, however, a regime of individualized hearings would cause administrative backlogs and substantial delays in achieving the benefits of increased production and lower overall prices. 51 Fed. Reg. at 46,785-46,786 (J.A. 302). It also would detract from the negotiations that the GFN feature of the Order was designed to facilitate. Section 7(b) does not require that Order No. 451 be burdened with such self-defeating procedures.

The courts consistently have held that an individualized administrative hearing is "due" only when there are disputed issues of material and historical fact that bear on the resolution of the matter to be decided. By contrast, legislative-type facts and questions of policy—such as those underlying the pricing, GFN, abandonment and other provisions of Order No. 451—may be resolved through rulemaking and need not be addressed again on a case-by-case basis. See, *e.g.*, *Heckler* v. *Campbell*, 461 U.S. 458, 467 (1983); *Permian Basin*, 390 U.S. at 774-777; *FPC* v. *Texaco, Inc.*, 377 U.S. 33, 41-44 (1964). The rulemaking proceeding itself is the only hearing that is "due" on those questions, and respondents were given a full opportunity to participate in that proceeding. See 51 Fed. Reg. at 46,786-46,787 (J.A. 304-309). Having determined at the conclusion of those rulemaking proceedings that the myriad relevant factors justified the higher price ceiling it adopted in Order No. 451 from the perspective of the natural gas market as a whole, the Commission was not required to relitigate the wisdom of those statutory policy judgments as applied to the circumstances of each contract between a producer and pipeline.

The apparent conclusion by the court below that the term "due hearing" in Section 7(b) requires precisely that sort of individualized hearing not only conflicts with the foregoing principles, it also is inconsistent with a line of D.C. Circuit decisions that have sustained the Commission's approach. In *Associated Gas Distributors* v. *FERC*, 824 F.2d 981 (1981), cert. denied, 485 U.S. 1006 (1988), that court upheld the relevant provisions of

the Commission's comprehensive regulations permitting interstate pipelines in certain circumstances to abandon their contractual obligation to provide sales service when pipeline customers choose to "convert" from sales service to firm transportation service. 824 F.2d at 1013-1016. The court concluded that there is "no procedural objection to the Commission's identification of circumstances, in an otherwise valid rulemaking, which automatically trigger its approval of abandonment (*i.e.*, establish a system of 'pre-granted' abandonment approval)." *Id.* at 1015 n.17. Similarly, in *Kansas Power & Light Co.* v. *FERC*, 851 F.2d 1479, 1483-1486 (1988), the D.C. Circuit upheld the Commission's authorization of pre-granted "limited term abandonment" against the claim that the "due hearing" language found in Section 7(b) of the NGA necessarily requires a trial-type evidentiary hearing. And in *Panhandle Eastern Pipe Line Co.* v. *FERC*, No. 89-1354 (D.C. Cir. June 29, 1990), the court reiterated that "the Commission may use a rulemaking to identify circumstances where the public interest will be served by a particular consent," and then, where appropriate, limit the scope of later adjudications to whether those circumstances are present. Slip op. 5 (citing *Heckler* v. *Campbell*, 461 U.S. at 467)."[17] Under Order No. 451, if a purchaser objects to a proposed abandonment on the ground that the conditions specified in the Order as prerequisites to receiving the Commission's approval are not present, it may, of course, challenge the producer's proposed action by filing a complaint with the Commission. See 18 C.F.R. 385.206. But where those conditions are present, the Commission has reasonably concluded that its "permission and approval" of the abandonment should be granted, in furtherance of the policies of Order No. 451 as a whole.

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[17] The D.C. Circuit also expressly "disagree[d]" with the decision of the court below in this case, "[t]o the extent that the *Mobil* court reads *United Gas Pipe Line Co.* v. *McCombs*, 442 U.S. 529 (1976), as barring *any* provision for generic, pre-granted abandonment." Slip op. 6.

III. THE COMMISSION WAS NOT REQUIRED TO IMPLEMENT A COMPREHENSIVE SOLUTION TO THE "TAKE-OR-PAY" PROBLEM IN CONNECTION WITH ORDER NO. 451 BEFORE RAISING THE CEILING PRICE FOR OLD GAS

The court of appeals' errors in this case were not limited to its construction of Sections 104(b)(2) and 106(c) of the NGPA and Section 7(b) of the NGA. It also strayed far afield into a discussion of the "take-or-pay" problem, and seemed to be of the view that the Commission should have implemented a comprehensive solution to that problem before raising the price of old gas under Order No. 451. See Pet. App. 29a-32a.

Over the last several years, both the Commission and the natural gas industry have grappled with the issues arising from "take-or-pay" clauses found in sales contracts between producers and pipelines. A "take-or-pay" clause typically obligates a pipeline to purchase a specified volume of gas at a specified price and, in the event it is unable to do so, to pay for that volume. See *Transco*, 474 U.S. at 412. Most of these contracts were executed between 1977 and 1982, years marked by serious natural gas shortages and high natural gas prices. See generally Pet. App. 29a-30a; *Associated Gas Distributors* v. *FERC*, 824 F.2d at 1021. Market conditions changed dramatically in the 1980s, however, upsetting the expectations of parties to take-or-pay contracts. Natural gas shortages of the type that led to the enactment of the NGPA gave way to a market characterized by gas oversupply, reduced gas demand, and lower gas rates. Many pipelines subsequently found themselves unable to take enough gas under high-cost take-or-pay contracts to avoid substantial take-or-pay liabilities, which were cumulatively worth many billions of dollars.

After explaining the magnitude of the take-or-pay problem, Pet. App. 29a-30a, the court of appeals expressed the belief that the Commission had failed to address it. Then, characterizing that supposed inaction as both "regrettable and unwarranted," the court appeared to require the Commission to address and solve the take-or-pay problem as a condition precedent to the lawful

promulgation of Order No. 451. See *id.* at 31a-32a. If the court of appeals did intend this to be an independent ground for invalidating Order No. 451, it clearly overstepped the bounds of judicial review.

The first error in what Judge Brown understood to be the majority's direction to the Commission "to consider, and once and for all to *solve*," the problem of take-or-pay contracts (Pet. App. 57a-58a (Brown, J., dissenting)) lies in its failure to appreciate that the Commission in fact has devoted great attention to the take-or-pay problem. Specifically, in combination with its efforts to induce a more competitive market, the Commission initiated rulemaking proceedings, primarily concerning Order Nos. 436 and 500, that were intended to reduce overall take-or-pay liabilities and to allocate take-or-pay costs equitably among all levels of the natural gas industry.[18] Those efforts are described in detail in our petition for a writ of certiorari (at 4-13) in *FERC* v. *Associated Gas Distributors*, petition for cert. pending, No. 89-2016 (filed June 22, 1990), in which we seek review of the D.C. Circuit's invalidation of one of the Commission's central initiatives to that end. The Commission's "equitable sharing" approach thus far has been quite successful in promoting resolution of take-or-pay liability between pipelines and producers, resulting in settlements reducing current and future pipeline take-or-pay liability by a total of approximately $44 billion. Those

[18] Order No. 436, *Regulation of Natural Gas Pipelines After Partial Wellhead Decontrol*, 50 Fed. Reg. 42,408 (1985), 1982-1985 FERC Stats. & Regs. [Regs. Preambles] (CCH) ¶ 30,665 (1985), aff'd in part and remanded in part *sub nom. Associated Gas Distributors* v. *FERC*, 824 F.2d 981 (D.C. Cir. 1987), cert. denied, 485 U.S. 1006 (1988). The Commission subsequently repromulgated Order No. 436, with certain revisions, as Order No. 500, 52 Fed. Reg. 30,334 (1987), FERC Stats. & Regs. [Regs. Preambles] (CCH) ¶ 30,761 (1987), record remanded *sub nom. American Gas Ass'n* v. *FERC*, 888 F.2d 136 (D.C. Cir. 1989). Following the remand, the Commission issued Order No. 500-H, 54 Fed. Reg. 52,344 (1989), FERC Stats. & Regs. [Regs. Preambles] (CCH) ¶ 30,867 (1989), on reh'g, Order No. 500-I, FERC Stats. & Regs. [Regs. Preambles] (CCH) ¶ 30,880 (1990), petitions for review pending *sub nom. American Gas Ass'n* v. *FERC*, No. 87-1588 (D.C. Cir. argued May 8, 1990).

settlements have come at a cost to the pipelines of approximately $9 billion, much of which has been passed on to pipeline customers under the equitable sharing approach. 89-2016 Pet. 11, 17, 28-29.[19] The court of appeals' belief that nothing has been done to address the take-or-pay problem therefore is completely without foundation.[20]

The court below also erred in believing that the Commission was insensitive to the take-or-pay issue when it adopted Order No. 451. The Commission did not purport to offer a comprehensive solution to that problem in Order No. 451, since, as it pointed out at the time, take-or-pay issues were already being addressed head-on in separate proceedings. 51 Fed. Reg. at 22,174-22,175, 22,196, 46,783-46,784 (J.A. 33-37, 120-121, 292-295). But the Commission did take the take-or-pay problem into account in fashioning Order No. 451. In fact, the Commission specifically intended the GFN procedure established by the Order to encourage the settlement of take-or-pay disputes and the renegotiation of "mixed" contracts for the sale of both old gas and high-cost gas. *Id.* at 22,196-22,197 (J.A. 120-122). The court of appeals was of the view that the GFN procedure is "one-sided" and fails to give pipelines sufficient leverage. Pet. App. 31a. As we have explained (see page 42, *supra*), the court was wrong. See also Pet. App. 59a (Brown, J., dissenting) (noting the "substantial bargaining leverage" thus provided to pipelines). In any event, this is precisely the sort of question on which a court should not substitute its judgment for that of the expert agency charged by Congress with making that very sort of prediction. And as it turned out, the Department of Energy reported to Congress during its consideration of the Na-

[19] See Order No. 500-H, *supra*, FERC Stats. & Regs. at 31,522-31,523.

[20] This error by the court below is all the more remarkable because it previously recognized in *Transwestern Pipeline Co.* v. *FERC*, 820 F.2d 733, 744 (5th Cir. 1987), cert. denied, 484 U.S. 1005 (1988), that the "take-or-pay issue" is a "separate matter which is being addressed in other proceedings" and that "[t]he Commission is not ignoring the issue."

tural Gas Wellhead Decontrol Act of 1989, discussed below, that take-or-pay issues were resolved in 33% of the large-producer contracts that were renegotiated pursuant to or in light of Order No. 451.[31]

Of course, Order No. 451 could not offer a comprehensive resolution of all outstanding take-or-pay liabilities (particularly those involving new gas), since it was directed primarily to the distinct issue of price ceilings for old gas. Our point is simply that, on its own terms, Order No. 451 did address the issue.

In these circumstances, the court of appeals plainly erred to the extent it sought to direct the Commission to reorder its regulatory priorities so as to address and solve the take-or-pay problem in the context of raising the price ceilings for old gas—most of which is not subject to the take-or-pay contracts that were entered into between 1977 and 1982. This Court has made clear that an agency has exceedingly broad discretion to determine the proper ordering of its priorities and to select appropriate vehicles for addressing those priorities. In *Vermont Yankee Nuclear Power Corp.* v. *NRDC, Inc.*, 435 U.S. 519 (1978), the Court held that it is "absolutely clear" that "[a]bsent constitutional constraints or extremely compelling circumstances the 'administrative agencies "should be free to fashion their own rules of procedure and to pursue methods of inquiry capable of permitting them to discharge their multitudinous duties."'" *Id.* at 543-544 (quoting *FCC* v. *Schreiber*, 381 U.S. 279, 290 (1965)). Indeed, in *FPC* v. *Sunray DX Oil Co.*, 391 U.S. 9 (1968), the Court, applying the same general principles, explicitly affirmed the discretion of the Commission to address take-or-pay issues in proceedings of the Commission's own choosing, namely, pipeline proceedings rather than producer proceedings. *Id.* at 49-52.[32]

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[31] See *Natural Gas Price Controls: Hearing on H.R. 1595 Before the Subcomm. on Energy and Power of the House Comm. on Energy and Commerce*, 101st Cong., 1st Sess. 158-159 (1989).

[32] See also *FPC* v. *Transcontinental Gas Pipe Line Corp.*, 423 U.S. 326, 333 (1976) (Commission should be permitted to "exercise its administrative discretion in deciding how, in light of internal

Under these principles, the court of appeals had no authority to direct the Commission to address the take-or-pay problem in the Order No. 451 proceeding, "under penalty of forfeiting its judgmental conclusion on increased price for old gas [and] abandonment." Pet. App. 58a (Brown, J., dissenting). Certainly nothing in Sections 104(b)(2) and 106(c) of the NGPA authorizes a court to impose such a condition precedent. Those Sections authorize the Commission to raise the ceiling price of "*any* first sale of *any* natural gas," 15 U.S.C. 3314(b)(2), 3316(c) (emphasis added), without regard to whether that gas (or other gas covered by a contract between the same producer and purchaser) is subject to a take-or-pay clause.

IV. CONGRESS'S ENACTMENT OF THE WELLHEAD DECONTROL ACT CONFIRMS THE SOUNDNESS OF ORDER NO. 451

The soundness of Order No. 451 under the NGPA standing alone is reinforced by the basis on which Congress passed the Wellhead Decontrol Act of 1989, which lifts controls on wellhead sales of natural gas effective January 1, 1993. Pub. L. No. 101-60, § 2(b), 103 Stat. 158. In its deliberations on that Act, Congress recognized that "[c]hanges in the natural gas industry and in the framework for Federal natural gas regulation that have occurred over the past decade * * * make the repeal of remaining wellhead controls appropriate." S. Rep. No. 39, 101st Cong., 1st Sess. 5 (1989). Among the Commission actions cited by Congress in this regard was Order No. 451, which Congress believed would function essentially as a transitional device between the NGPA and decontrol. *Id.* at 5-6; H.R. Rep. No. 29, 101st Cong., 1st Sess. 6 (1989).

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organization considerations, it may best proceed to develop * * * the methods, procedures, and time dimension of the needed inquiry"); *Wisconsin Gas Co.* v. *FERC*, 770 F.2d 1144, 1159-1160 (D.C. Cir. 1985) ("for the reviewing court to maintain its proper function, it cannot require agencies to solve all problems that may be related to a particular decision at the same time"), cert. denied, 476 U.S. 1114 (1986).

Moreover, Congress recognized in enacting the Wellhead Decontrol Act that "[t]hrough [Commission] initiatives, more competition in the interstate pipeline industry has brought lower prices to all consumers, including captive residential consumers," and it premised the future decontrol of natural gas on its disapproval of many of the same market conditions and other factors the Commission sought to address in promulgating Order No. 451. H.R. Rep. No. 29, *supra*, at 3-4, 5-7; S. Rep. No. 39, *supra*, at 3-6. Congress further recognized that as a result of the Commission's initiatives, "[w]hile about one-third of our supplies are still controlled, most of those controls are well above market levels," and only about 5% of the nation's total gas supply was still subject to price controls at below-market levels. H.R. Rep. No. 29, *supra*, at 3-4; S. Rep. No. 39, *supra*, at 3. In short, Congress's decision to proceed with wellhead decontrol because of its approval of what the Commission had accomplished administratively confirms the Commission's considered judgment that the elimination of the vintage-pricing system in Order No. 451 (along with other measures to promote competition in the natural gas industry) comports with both the policies of the NGPA and the long-term interests of consumers.

CONCLUSION

The judgment of the court of appeals should be reversed.

Respectfully submitted.

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APPENDIX

STATUTORY AND REGULATORY PROVISIONS INVOLVED

A. RELEVANT STATUTORY PROVISIONS

1. Section 4(a) of the Natural Gas Act of 1938, as codified at 15 U.S.C. 717c(a), provides:

(a) Just and reasonable rates and charges

All rates and charges made, demanded, or received by any natural-gas company for or in connection with the transportation or sale of natural gas subject to the jurisdiction of the Commission, and all rules and regulations affecting or pertaining to such rates or charges, shall be just and reasonable, and any such rate or charge that is not just and reasonable is declared to be unlawful.

2. Section 5(a) of the Natural Gas Act of 1938, as codified at 15 U.S.C. 717d(a), provides:

§ 717d. Fixing rates and charges; determination of cost of production or transportation

(a) Decreases in rates

Whenever the Commission, after a hearing had upon its own motion or upon complaint of any State, municipality, State commission, or gas distributing company, shall find that any rate, charge, or classification demanded, observed, charged, or collected by any natural-gas company in connection with any transportation or sale of natural gas, subject to the jurisdiction of the Commission, or that any rule, regulation, practice, or contract affecting such rate, charge, or classification is unjust, unreasonable, un-

duly discriminatory, or preferential, the Commission shall determine the just and reasonable rate, charge, classification, rule, regulation, practice, or contract to be thereafter observed and in force, and shall fix the same by order: *Provided, however,* That the Commission shall have no power to order any increase in any rate contained in the currently effective schedule of such natural gas company on file with the Commission, unless such increase is in accordance with a new schedule filed by such natural gas company; but the Commission may order a decrease where existing rates are unjust, unduly discriminatory, preferential, otherwise unlawful, or are not the lowest reasonable rates.

3. Section 7(b) of the Natural Gas Act of 1938, as codified at 15 U.S.C. 717f(b), provides:

(b) Abandonment of facilities or services; approval of Commission

No natural-gas company shall abandon all or any portion of its facilities subject to the jurisdiction of the Commission, or any service rendered by means of such facilities, without the permission and approval of the Commission first had and obtained, after due hearing, and a finding by the Commission that the available supply of natural gas is depleted to the extent that the continuance of service is unwarranted, or that the present or future public convenience or necessity permit such abandonment.

4. Section 104 of the Natural Gas Policy Act of 1978, as codified at 15 U.S.C. 3314, provides:

§ 3314. Ceiling price for sales of natural gas dedicated to interstate commerce

(a) Application

In the case of natural gas committed or dedicated to interstate commerce on November 8, 1978, and

for which a just and reasonable rate under the Natural Gas Act [15 U.S.C. 717 et seq.] was in effect on such date for the first sale of such natural gas, the maximum lawful price computed under subsection (b) of this section shall apply to any first sale of such natural gas delivered during any month.

(b) Maximum lawful price

(1) General rule

The maximum lawful price under this section for any month shall be the higher of—

(A)(i) the just and reasonable rate, per million Btu's, established by the Commission which was (or would have been) applicable to the first sale of such natural gas on April 20, 1977, in the case of April 1977; and

(ii) in the case of any month thereafter, the maximum lawful price, per million Btu's, prescribed under this subparagraph for the preceding month multiplied by the monthly equivalent of the annual inflation adjustment factor applicable for such month, or

(B) any just and reasonable rate which was established by the Commission after April 27, 1977, and before November 9, 1978, and which is applicable to such natural gas.

(2) Ceiling prices may be increased if just and reasonable

The Commission may, by rule or order, prescribe a maximum lawful ceiling price, applicable to any first sale of any natural gas (or category thereof, as determined by the Commission) otherwise subject to the preceding provisions of this section, if such price is—

(A) higher than the maximum lawful price which would otherwise be applicable under such provisions; and

(B) just and reasonable within the meaning of the Natural Gas Act [15 U.S.C. 717 et seq.].

5. Section 106 of the Natural Gas Policy Act, as codified at 15 U.S.C. 3316, provides in pertinent part:

§ 3316. Ceiling price for sales under rollover contracts

(a) Interstate rollover contracts

In the case of the first sale under any rollover contract of natural gas which was committed or dedicated to interstate commerce on November 8, 1978, the maximum lawful price under this subsection for such natural gas delivered during any month shall be the higher of—

(1)(A) in any case of the month in which the effective date of such rollover contract occurs, the just and reasonable rate, if any, per million Btu's, established by the Commission and applicable on such date to the natural gas subject to the expired contract; and

(B) in the case of any month thereafter, the maximum lawful price, per million Btu's, prescribed under this paragraph for the preceding month multiplied by the monthly equivalent of the annual inflation adjustment factor applicable for such month; or

(2)(A) $0.54 per million Btu's, in the case of April 1977; and

(B) in the case of any month thereafter, the maximum lawful price, per million Btu's, prescribed under this paragraph for the preceding month multiplied by the monthly equivalent of the annual inflation adjustment factor applicable for such month. For purposes of this subsection, the term "rollover contract" includes any contract which would have been a rollover contract but for the fact that the expiration of the previous contract occurred prior to November 8, 1978.

(b) Intrastate rollover contracts

(1) General rule

In the case of any first sale under any rollover contract of natural gas which was not committed or dedicated to interstate commerce on November 8, 1978, the maximum lawful price under this subsection for such natural gas delivered during any month shall be the higher of—

(A)(i) the maximum price paid under the expired contract, per million Btu's, in the case of the month in which the effective date of such rollover contract occurs; and

(ii) in the case of any month thereafter, the maximum lawful price, per million Btu's, prescribed under this subparagraph for the preceding month multiplied by the monthly equivalent of the annual inflation adjustment factor applicable for such month; or

(B)(i) $1.00 per million Btu's, in the case of April 1977; and

(ii) in the case of any month thereafter, the maximum lawful price, per million Btu's, prescribed under this subparagraph for the preceding month multiplied by the monthly equivalent of the annual inflation adjustment factor applicable for such month.

(2) Certain State or Indian production or royalty shares

*   *   *   *   *

(c) Ceiling price may be increased if just and reasonable

The Commission may, by rule or order, prescribe a maximum lawful price, applicable to any first sale of any natural gas (or category thereof, as determined by the Commission) otherwise subject to the preceding provisions of this section, if such price is—

(1) higher than the maximum lawful price which would otherwise be applicable under such provisions; and

(2) just and reasonable within the meaning of the Natural Gas Act [15 U.S.C. 717 et seq.].

B. RELEVANT REGULATORY PROVISIONS ADOPTED BY ORDER NO. 451, AS AMENDED

1. 18 C.F.R. 157.301 provides:

§ 157.301 Blanket certificate authority, pregranted abandonment, and reporting requirements.

(a) *Blanket certificate authority.* Any first seller of natural gas that is authorized to abandon the sale of gas under § 157.30 (c) or (d) or the good faith negotiation procedures set forth in § 270.201 of this chapter, is granted a certificate of public convenience and necessity to sell such gas for resale in interstate commerce, subject to the reporting requirements of paragraph (c) of this section.

(b) *Pre-granted abandonment.* Any first seller who sells natural gas under the blanket certificate authority of paragraph (a) of this section is authorized to abandon the sale upon termination of the contract under which the sale is made.

(c) *Reporting requirement.* Any first seller who makes sales under the blanket certificate authority of this section must file a report with the Commission not later than April 1 of each year providing the following information with respect to any sales under that certificate initiated during the preceding calendar year:

(1) Name of former purchaser;

(2) Name of new purchaser;

(3) Location of sale (field, block, county, state, etc.);

(4) Contract date;

(5) Contract term;

(6) Average price; and

(7) Estimated annual sales volume (mcf).

(d) *Waiver of rate filing requirements.* The rate filing requirements of §§ 154.92 and 154.94 of this chapter are waived for sales under a certificate granted by this section.

2. 18 C.F.R. 270.201 provides:

§ 270.201 Good faith negotiation procedures.

(a) *Applicability definitions, and general rules.* (1) This section applies to requests for renegotiation of the price of old gas sold under an existing contract.

(2) For purposes of this section:

(i) "Old gas" means natural gas which, if sold, would be subject to a maximum lawful ceiling price under section 104 or 106(a) of the NGPA.

(ii)(A) "Existing contract" means a contract in effect on July 18, 1986, or an expired contract pursuant to which sales of natural gas are continuing on that date under the service obligation of a certificate of public convenience and necessity, that includes the sale of any old gas and provides authority for the first seller to collect a higher price upon establishment by the Commission of a higher maximum lawful price.

(B) An existing contract includes the sale of old gas if, on July 18, 1986, the contract encompasses

the sale of any gas that has not been abandoned under section 7(b) of the Natural Gas Act and which, if sold, would be priced as old gas, whether or not any old gas is sold on that date.

(iii) The terms "first seller" and "party to a contract" include:

(A) An owner of a working interest in an oil or gas lease that has a direct contractual relationship with a purchaser for a "first sale" of gas, as defined in section 2(21) of the NGPA; and

(B) An operator of an oil or gas lease that has a direct contractual relationship with a purchaser for a "first sale" on behalf of any owner of a working interest in the lease that does not have such a relationship.

(3)(i) Any existing contract under which old gas is sold may be renegotiated or amended at any time to provide for a price up to the alternative maximum lawful price under § 271.402(c)(7)(i) of this chapter without using the good faith negotiation procedures.

(ii) A price for old gas that exceeds the otherwise applicable maximum lawful price under § 271.402 of this chapter may be collected under an existing contract only if the first seller and purchaser agree upon a price up to the alternative maximum lawful price under § 271.402(c)(7)(ii) in accordance with this section.

(4) A party to an existing contract may not request a nomination of a price under the provisions of this section for any gas sold under the contract if that party:

(i) And the purchaser or first seller have renegotiated the price or any other term for the sale of any old gas under the contract after July 18, 1986, without using the good faith negotiation procedures of this section, and have not agreed in writing to preserve their rights under this section:

(ii) Has previously requested nomination of a price under paragraph (b)(1) of this section for any gas sold under the contract; or

(iii) Has been requested under this section to nominate a price for any gas sold under the contract, and the last date has passed under paragraphs (b)(2) or (b)(3) of this section to request the other party to nominate a price for gas sold under the contract.

(5)(i) A first seller that validly assigns or otherwise transfers gas subject to an existing contract on or after June 3, 1987 may not request a nomination of price under the provisions of this section for any gas sold under any existing contract with that purchaser unless the purchaser's right to renegotiate, under the provisions of this section, the terms of sale of the assigned gas are unaffected by the assignment.

(ii) A first seller to whom gas subject to an existing contract is validly assigned, or otherwise transferred, on or after June 3, 1987 may not request nomination of a price under the provisions of this section for the assigned gas, unless the purchaser's right to renegotiate, under the provisions of this section, the terms of sale of all gas sold under any existing contract between the purchaser and the assignor on June 3, 1987 are unaffected by the assignment.

(6) Any request for nomination of a price under this section, any nomination of a price in response to such a request, and any notice of abandonment of sales or termination of purchases under this section must be sent by U.S. mail, return receipt requested.

(7) Any deadline under this section for requesting a nomination of a price, or for nominating a price in response to such a request, may be extended by mutual agreement of the parties in writing. Any notice required under this section to be given before a first seller or purchaser abandons or terminates

sales or purchasers may be shortened by mutual agreement of the parties in writing.

(8) A party nominating a price may propose a change in any other terms of the existing contract, and for purposes of this section, the terms "nominated price" and "nomination" may include such a proposed change.

(b) *Requests for negotiation and nomination of price.*

(1)(i) At any time after January 23, 1987, a first seller may request the purchaser to nominate a price at which the purchaser is willing to continue buying old gas under any existing contract by submitting a written request to the purchaser, and may specify the wells or category of wells under each contract for which the first seller requests a renegotiated price.

(ii) When requesting a nomination of a price under this paragraph, a first seller may also request the purchaser to provide the first seller with a current list of all of the purchaser's firm sales customers, including the name and address of an employee or agent responsible for negotiating purchases of natural gas on behalf of the customer. The purchaser must send the list of customers to the first seller within 30 days after receiving the request and must include a certification of its completeness and accuracy. The list must be sent by U.S. mail, return receipt requested.

(2) Within 30 days after receiving a request for nomination of a price under paragraph (b)(1) of this section, the purchaser may request the first seller to nominate a price at which the first seller is willing to continue selling any gas, including old gas for which the first seller has requested a nomination of price by the purchaser, under any existing contract with the purchaser that includes the sale of any old gas, whether or not named in the first seller's request, by submitting a written request to the first seller.

(3) Within 30 days after receiving a request from a purchaser for nomination of a price for any gas under a contract that is not named in the first seller's request and that includes the sale of any old gas, the first seller may request the purchaser to nominate a price at which the purchaser is willing to continue buying any old gas under that contract, including old gas for which the purchaser has requested a nomination of price by the first seller, by submitting a written request to the purchaser.

(4) A first seller's request for nomination of a price under paragraph (b)(1) of this section constitutes an offer to release the purchaser from its contract obligation to purchase any gas sold under any existing contract with the first seller, whether or not named in the first seller's request, that includes the sale of any old gas.

(5)(i) The provisions of this paragraph apply when (A) a first seller validly assigns (or otherwise transfers) gas subject to an existing contract to another first seller on or after June 3, 1987 and (B) the assignor or assignee is eligible to request nomination of a price under paragraph (b)(1) of this section.

(ii) If the assignor requests nomination of a price, under paragraph (b)(1) of this section, for old gas sold under any contract between it and the purchaser, the purchaser may request nomination of a price under paragraph (b)(2) of this section for any gas which on June 3, 1987 was subject to an existing contract between the purchaser and the assignor.

(iii) If the assignee requests nomination of a price under paragraph (b)(1) of this section for the assigned gas, the purchaser may request nomination of a price for any gas which on June 3, 1987

was subject to an existing contract between the assignor and the purchaser, but the purchaser may not request nomination of a price for any other gas.

(iv) If the assignee requests nomination of a price under paragraph (b)(1) of this section for old gas other than the assigned gas, the purchaser may not request nomination of a price under paragraph (b)(2) of this section for the assigned gas.

(v) The purchaser must address any requests for nomination of a price authorized by paragraphs (b)(5) (ii) or (iii) of this section to the first seller currently selling it the gas for which nomination of a new price is requested.

(vi) If a first seller receives a request for nomination of a price authorized by paragraph (b)(5) (ii) or (iii) of this section with respect to an existing contract for which it did not make a nomination request under paragraph (b)(1) of this section, the first seller may request under paragraph (b)(3) of this section that the purchaser nominate a price for any old gas sold under that contract, whether or not the contract was named in the nomination request of the assignor or assignee under paragraph (b)(1) of this section.

(c) *No response to request for nomination.* (1) If the purchaser does not nominate a price in writing within 60 days after receiving the first seller's request for nomination of a price, the first seller may offer to sell all or part of the gas named in its request for nomination to a new purchaser. The first seller is authorized, upon 30-days written notice to the existing purchaser, to abandon the sale of the gas if the first seller enters into a written contract for the sale of all or part of the gas to a new purchaser after any necessary compliance with paragraph (g) of this section.

(2) If the first seller does not nominate a price in writing within 60 days after receiving the purchaser's request for nomination of a price, the purchaser may terminate its purchases of all or part of the gas named in its request for nomination at any time upon 60-days written notice to the first seller.

(d) *Purchaser's nomination of highest price.* If the purchaser nominates in writing the highest price to which an existing contract price could escalate with the purchaser's agreement under § 271.402 (c)(7)(ii) of this chapter, and the purchaser does not propose a change in any term of the contract, sales must continue at the nominated price under the terms of the existing contract.

(e) *Purchaser's nomination of lower price; first seller's options.* (1) If the purchaser nominates in writing a price less than the highest price to which the existing contract price could escalate or proposes a change in any other term of the contract, the first seller must accept or reject the nominated price in writing within 30 days after receiving the nomination. If the first seller does not accept the purchaser's nominated price in writing within 30 days, the nominated price is deemed rejected.

(2) If the first seller accepts the nominated price, sales must continue at the agreed-upon price under the other terms of the existing contract, unless such terms are renegotiated by the parties.

(3) If the first seller rejects the nominated price, the first seller must continue sales to the purchaser at the existing price until the sale of the gas is abandoned under this paragraph. At any time after a rejection, the first seller may offer to sell to a new purchaser all or part of the gas for which no price is agreed upon under this paragraph.

(4) A first seller is authorized, upon 30-days written notice to the existing purchaser, to abandon the sale of any gas offered under this paragraph for which the first seller enters into a written contract

with a new purchaser after any necessary compliance with paragraph (g) of this section.

(f) *First seller's nomination of price; purchaser's options.* (1) If the first seller nominates a price in writing in response to the purchaser's request under paragraph (b)(2) of this section, the purchaser must accept or reject the nominated price in writing within 30 days after receiving the nomination. If the purchaser does not accept the first seller's nominated price in writing within 30-days, the nominated price is deemed rejected.

(2) If the purchaser accepts the nominated price, purchases must continue at the agreed-upon price under the other terms of the existing contract, unless such terms are renegotiated by the parties.

(3) If the purchaser rejects the nominated price, the purchaser may at any time terminate its purchases of all or part of the gas named in its request for nomination upon 60-days written notice to the first seller.

(4) The terms of the existing contract apply until the first seller's nominated price or terminates purchases of the gas under this paragraph.

(5) A first seller is authorized to abandon sales of the gas to the purchaser if the purchaser terminates purchases of gas under this section and the first seller enters into a written contract for the sale of the gas to a new purchaser after any necessary compliance with paragraph (g) of this section.

(g) *Existing firm sales customers' right of first refusal*—(1) *General rule.* (i) If the first seller offers to sell gas subject to release due to termination or abandonment under paragraphs (c), (e), or (f) of this section ("offer") to a new purchaser that is not an existing firm sales customer of the existing purchaser, the first seller must present the same offer to all existing firm sales customers, if:

(A) The existing purchaser is not subject to the nondiscriminatory access provisions of § 284.8(b) or § 284.9(b) of this chapter, and;

(B) The offer encompasses the sale of any gas subject to the Commission's jurisdiction under section 1(b) of the Natural Gas Act and is substantially accepted in principle by the new purchaser in an arms-length transaction.

(ii) Any existing firm sales customer has a right of first refusal to purchase the gas under the terms of the offer. The offer must be presented in accordance with the provisions of this paragraph.

(2) *Making the offer.* The offer to a new purchaser that is not an existing firm sales customer must be presented to all such customers of the existing purchaser not later than 10 days after the offer is substantially accepted in principle by the new purchaser. The offer must be tendered by U.S. mail, return receipt requested.

(3) *Acceptance and rejection of offer; no counteroffer.* (i) An existing firm sales customer must accept the offer in writing within 20 days after receiving the offer. The offer is deemed accepted when it is signed and placed in the U.S. mail, return receipt requested. If the offer is not accepted by an existing firm sales customer within 20 days of its receipt, the offer is deemed rejected.

(ii) Any written counteroffer by an existing firm sales customer constitutes a rejection.

(iii) If the first seller receives more than one acceptance from an existing firm sales customer, the first seller may determine which such customer will become the new purchaser.

(4) *Termination of right of first refusal.* If no existing firm sales customer accepts the offer made under this paragraph within 20 days of receiving the offer, the first seller may execute a written contract

with the new purchaser that substantially accepted the offer before it was sent to the existing firm sales customers. Such written contract with a new purchaser is not subject to a right of first refusal.

(5) *Definition.* For purposes of this section, "existing firm sales customer" means a customer with which the existing purchaser has a contract for the sale of gas not subject to prior claim by another customer or another class of service, and at the same priority as any other class of firm service, which is in effect on the date a new purchaser substantially accepts in principle an offer under paragraph (g)(1) of this section.

(h) *Transportation by existing pipeline purchaser.* A purchaser that is an interstate pipeline not subject to the non-discriminatory access provisions of § 284.8(b) or § 284.9(b) of this chapter must transport any gas released due to termination or abandonment under this section, on behalf of any shipper, to any existing customer of the interstate pipeline or to any pipeline to which the interstate pipeline is interconnected, and in accordance with § 284.225 of this chapter, if the purchaser:

(1) Does not submit a timely nomination of a price for gas under paragraph (c)(1) of this section in response to the first seller's request for nomination of a price;

(2) Nominates a price under paragragh (e)(1) of this section that is less than the highest price to which its existing contract price could escalate if it were a new or amended contract;

(3) Terminates purchases of gas under paragraph (c)(2) of this section when the first seller does not submit a timely nomination of a price; or

(4) Terminates purchases of gas under paragraph (f)(3) of this section after rejecting a price for gas nominated by the first seller.

3. 18 C.F.R. 271.402 provides in pertinent part:

§ 271.402 Maximum lawful prices.

* * * * *

(c) *Applicable higher rates.*

* * * * *

(3) In the case of any first sale under any rollover contract to which this subpart applies, the maximum lawful price for the month in which the effective date of such rollover contract occurs is the highest of:

(i) The maximum lawful price applicable to the expiring contract in the month in which the rollover contract becomes effective;

(ii) The price specified in Table II of § 271.101 (a) for interstate rollover gas; or

(iii) The price specified in Table II of § 271.101 (a) for post-1974 gas if the rollover contract becomes effective after July 18, 1986.

* * * * *

(7) The maximum lawful price, per MMBtu, for the first sales of all categories of gas otherwise subject to lower maximum lawful prices under this subpart is the price specified in Table II of § 271.101 (a) for post-1974 gas, if the price is established:

(i) Under a contract or contract amendment executed after July 18, 1986; or

(ii) In accordance with the good faith negotiation procedures of § 270.201 of this chapter.

4. 18 C.F.R. 271.602 provides:

§ 271.602 Maximum lawful price.

(a) *General rule.* The maximum lawful price for a first sale of natural gas under an intrastate roll-

over contract to which section 106(b)(1) of the NGPA applies shall be the highest of:

(1)(i) The maximum lawful price, per MMBtu, paid under the expired contract, in the month in which the rollover contract becomes effective; and

(ii) In any month after the month in which the rollover contract becomes effective, the maximum lawful price, per MMBtu, prescribed under this paragraph for the preceding month adjusted for inflation in accordance with § 271.102;

(2) The alternative maximum lawful price specified in Table 1 of § 271.101(a) for certain intrastate rollover gas; or

(3) The price specified in Table II of § 271.101 (a) for post-1974 gas, if the price is established under a contract or contract amendment executed after July 18, 1986.

(b) *Certain State or Indian production or royalty shares.* The maximum lawful price, per MMBtu, for natural gas to which section 106(b)(2) of the NGPA (relating to certain State or Indian natural gas production or royalty interests) applies shall be the price specified for new natural gas (Subpart P of Part 271) in Table I of § 271.101(a).

(c) *Qualified production enhancement gas.* For purposes of paragraph (a)(1)(i) of this section, the maximum lawful price, per MMBtu, paid under the expired contract is deemed to include any amount paid by reason of a maximum lawful price allowed under § 271.704 (relating to qualified production enhancement gas.)

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